WILLKIE FARR & GALLAGHER LLP **MEMORANDUM**

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Mayor Susan Golding on May 10, 2006

DATED: May 25, 2006

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On Wednesday, May 10, 2006, Benito Romano, in Willkie Farr & Gallagher LLP's ("Willkie") capacity as counsel to the Audit Committee, interviewed former Mayor Susan Golding. Mayor Golding was not represented by counsel at the interview. Heath Rosenthal of Willkie was also in attendance. The interview took place in a conference room on the third floor of the San Diego City (the "City") Administration Building and lasted approximately three hours.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Mayor Golding, and constitutes protected work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

## *Warnings*

At the outset of the interview, Mr. Romano explained to Mayor Golding that Willkie represents the Audit Committee created by the City Council. Mr. Romano also stated that although the material discussed during the interview would be treated as privileged, either covered by attorney-client privilege or the work product doctrine, in the likely event that the Audit Committee issues a report, the privilege will be lost. In addition, the City can waive the privilege even if no report is written. Mr. Romano further explained that because Willkie is cooperating with other investigations, we may be sharing information with the U.S. Attorney's Office, the SEC and the City's outside auditor, KPMG, and therefore Mayor Golding should be as accurate and truthful as possible. Mr. Romano also asked that the contents of the interview be kept confidential, and emphasized that Mayor Golding could seek clarification of a question at any time.

## *Background*

Mr. Romano asked Mayor Golding when she served as the Mayor of San Diego, and she responded that she was the Mayor of the City from December 1992 through December 2000. Mr. Romano then asked if she held any elected positions prior to taking office. Mayor Golding responded that she had served on the City Council and the Board of Supervisors for the County of San Diego before being elected Mayor. Mr. Romano asked how long she served on the Board of Supervisors. Mayor Golding said that she served two terms, for a total of eight years, on the Board of Supervisors immediately prior to becoming Mayor. Mr. Romano asked if her work for the Board of Supervisors was a full-time job, and she stated that it was. Mr.

Romano then inquired about Mayor Golding's employment after she left the Mayor's Office. Mayor Golding stated that she has sat on corporate boards for the past four to five years and currently runs her own consulting company. Mayor Golding explained that although her company previously did not do work concerning governmental entities, her company currently provides strategic advice relating to cities and counties.

At another point in the interview, Mr. Romano asked about Mayor Golding's educational background. Mayor Golding stated that she received her undergraduate degree from Carlton College and her masters degree from Columbia. She also was a Ph.D. Fellow at Emory University training to be a professor, but she moved to San Diego prior to completing that program.

***Campaign for Mayor & First Term in Office***

Mr. Romano inquired about the major issues of Mayor Golding's first campaign for mayor. She explained that the City's poor economy was the major issue of her campaign. Businesses were leaving the City and the City lost 100,000 white collar jobs during the defense conversion. (Later in her interview Mayor Golding noted that the City's economy had its highest growth rate ever while she was in office. The economy began improving in 1994, and as a result she cut business taxes and a record-low employment rate was reached. Mayor Golding said that the height of the economic growth occurred during her second term.) Mr. Romano asked Mayor Golding what the second biggest issue in her 1992 campaign was, and she responded that it was crime. Mayor Golding also noted that she ran on a platform of making San Diego technology-friendly because she believed that this would help business. Her opponent, Peter Navarro, had run on an "anti-growth" platform. Mr. Romano asked if the election for Mayor was non-partisan when Mayor Golding ran, and she stated that the election has been non-partisan since the 1930s. Mayor Golding also added that when she was elected, a poll was conducted and one-half of those surveyed thought that she was a Democrat and the half thought that she was a Republican. She explained that the issues in the mayoral races were not political.

Mr. Romano asked Mayor Golding whether she was familiar with the inner-workings of the City when she took office. Mayor Golding responded that she was familiar with the City's issues when she was elected Mayor because she had been a member of the Council and the majority of the district she had been responsible for while serving on the Board of Supervisors included the City. Mr. Romano asked whether Mayor Golding had a transition committee when she took office. Mayor Golding stated that she did have such a committee, though she could not recall who sat on it. She thought it was comprised of her business executive supporters.

Mr. Romano asked Mayor Golding to describe her staff. Mayor Golding stated that when she took office her staff had twenty to twenty-five people, including secretaries and clerks. Her staff also had a chief of staff, policy director, press secretary, deputy press secretary, and the "Officer of Commonsense" who was a person citizens could call any time they thought that something did not make sense. Mayor Golding stated that she created the Officer of Commonsense position in order to allow people to cut through the red tape of City government. She explained that she tried to create a "one-stop shop" for small businesses to get started, meaning that people could go to one place in the government to start a business and someone would walk them through how to do it. The object was to help people meet regulations and start their businesses as fast as possible.

Mr. Romano asked how the City economy was when Mayor Golding was elected in 1992. Mayor Golding stated that when she first was elected, property and sales tax revenues were down. As a result, she proposed cutting everyone's salaries, including her own, because salaries were a major part of the budget. However, Mayor Golding went to impasse with the unions in the 1993 budget year. She also explained that because City revenues were down, she charged the private sector community with allowing the City to be able to competitively bid on contracts, but this did not occur to the extent that she had hoped.

Mayor Golding volunteered information about certain actions she took during the beginning of her administration. First, she explained that during her first year in office she put together a City committee called "Change$^2$" (pronounced "Change 2"). That committee, which was comprised of well known business people, made 52 recommendations, and the Council adopted all but one of them. However, Mayor Golding stated that the recommendations were very difficult to implement because they related to private sector practices, but she wanted to benchmark the City against private sector practice. Mr. Romano asked if any of the 52 recommendations related to the City pension system, and Mayor Golding did not think they did. Mr. Romano asked if any of the recommendations related to the Meet and Confer process, and Mayor Golding did not think they did. She did note that one of the recommendations related to labor negotiations, but this was the one recommendation that the Council rejected.

### *Budget*

Mr. Romano asked Mayor Golding what her role was in setting the budget when she was Mayor. Mayor Golding responded that San Diego was not a pure City Manager government. During the era of Mayor Pete Wilson, changes were made that gave the Mayor more power, such as the ability to nominate people to important positions and set the agenda for Council meetings. However, she said that the City Manager, not the Mayor, set the budget. Mayor Golding stated that, nevertheless, she had influence over the budget before and after it was issued.

Mr. Romano next asked how the budgeting process worked. Mayor Golding explained that each department submitted its budget to the City Manager who then directed the process pursuant to the Charter. She added that the budget process always was frustrating for the Council and the Mayor because the citizens of San Diego thought that the Council and the Mayor had a lot more influence over the budget than they did. Mr. Romano asked Mayor Golding how she could change the budget. Mayor Golding stated that if she thought changes needed to be made, she would request such a change at a Council meeting and the Council would either accept or reject her change.

Mr. Romano then inquired about the chronology of how the budget got approved. Mayor Golding explained that the process began with hearing portions of budget in the Rules Committee as soon as the Manager had those portions ready, which occurred at different times from year to year. Mr. Romano asked when exactly this occurred. Ms. Golding stated that the first iteration of the budget became available in March, so the hearings probably occurred in either January or February. Mayor Golding also added that all Council members were invited to participate in this budget process so that they did not have to deal with budget issues only in Council meetings. Mr. Romano commented that he had heard that the budget was complicated to read. Mayor Golding agreed that the budget contained a good amount of detail. She also stated that budgets are extremely important and they can be made easily decipherable or not. When she was in office, she and the Council always wanted an Executive Summary of the budget because there were several Council members who would say at meetings that they did not get enough time to review the budget. She had wanted a regular time to meet with the Council members before the City Manager created the budget, probably in January, to decide on the ten most important policy items that should be in the budget that the City Manager was supposed to implement. (It was unclear from the interview whether this idea had ever been executed.)

Mr. Romano asked if Mayor Golding gave State of the City addresses while she was in office, and if so, whether she addressed the budget in those speeches. Mayor Golding responded that she did give State of City addresses in January of each year and said that her speeches often had budget discussions, but sometimes they did not. Mr. Romano asked if the City Manager listened to what Mayor Golding was saying in her addresses, and she said that they did. She explained that the State of City Address was designed to tell the City's citizens the state of the City at that time, not to set out a five-year plan. Nevertheless, Mayor Golding noted that she laid out a plan for her four years in office in her first State of the City address, and she told the citizens each year in subsequent State of the City addresses which parts of her plan had been implemented and which still needed to be worked on. Mr. Romano inquired whether there existed a process to help Mayor Golding and the Council focus on budgeting for the future. Mayor Golding responded that there was a recommendation for a two-year budget, and she had always wanted a five-year plan. However, she stated that whether the budget included planning for future years was up to the City Manager because he was in charge of the budget.

### *Wastewater*

Mr. Romano showed Mayor Golding a June 19, 1996 Manager's Report from Mr. McGrory to Mayor Golding and the Council recommending that the Mayor and Council direct Mr. McGrory to, among other things, reduce water capacity charges (Exhibit 1). Mr. Romano noted that the report appeared to be pro-business. Mayor Golding agreed that it was pro-business, but noted that it was also for affordable housing. Mr. Romano asked whether the report was a part of a larger initiative. Mayor Golding responded that she did not recall the report, but knew that she requested a review of the rates in February. She explained that before she came into office, the pubic was concerned with and would sometimes complain about the way in which water rates were implemented from a fairness perspective. Mayor Golding guessed that there were major complaints surrounding the content of the June 19 Manager's Report. She stated, however, that sometimes rates needed to be increased to make improvements. Mayor Golding recalled that when she took office, she could never get the rate increases she desired that were needed to make the improvements to the sewer system which was falling apart. Nevertheless, she stated that rate increases were approved, and the new funds were all supposed to go to overhaul the sewer system.

Mr. Romano asked if the rate increases were political, and Mayor Golding agreed that they were. She explained that raising rates in San Diego is very difficult and noted that the Mayor that preceded her wanted to keep the rates steady. Mayor Golding added that citizens wanted the City to be small and efficient and noted that this was the same time period when Ross

Perot ran for President. She also noted that San Diego was always fiscally conservative, and everyone felt overtaxed.

Later in her interview, Mayor Golding mentioned that she had created a sewer rate advisory committee because citizens came to the Council with concerns about the sewer rates being changed. Mr. Romano asked if she knew Dennis Kahlie (Rate Analyst), and she stated that she did not.

Mr. Romano asked whether Mayor Golding had a policy to review public offerings. Mayor Golding responded that she had wanted to set up an outside financial body to review offerings, but she could not recall what happened. Although some people were in favor of this idea (she could not recall names), she did not think there was enough support for it at that time. Mayor Golding explained that the public offerings were reviewed by the City's financial management staff and outside bond council who then advised her about the offerings. Mr. Romano asked whether Paul Webber was part of that outside bond council team, and Mayor Golding said that he was. Mr. Romano then asked whether there were times when Mr. Webber had concerns that were different than those of the City. Mayor Golding agreed that while Mr. Webber did have differing views than those of the City at times, this did not include issues related to Wastewater.

Mr. Romano asked whether Mayor Golding recalled a presentation made by Mr. Kahlie at a closed session hearing, and she stated that she did not. Mr. Romano asked whether she recalled the State Revolving Fund issues, and she stated that she did not. Mr. Romano showed Mayor Golding an October 6, 1999 memorandum from George Loveland to Mayor Golding and the Council transmitting copies of the Water and Sewer Cost of Service Studies ("COSS") undertaken in fiscal years 1997 and 1998, noting that the water and sewer rate structures adopted by the Council are both business-friendly and consistent with Proposition 218, and recommending that no changes occur (Exhibit 2). Mr. Romano asked whether Mayor Golding recalled this memorandum. Mayor Golding responded that she remembered a review of the water, but not sewer rates. She explained that she was trying to get the City to go digital because she found out that some business were not billed for water for ten years which she found to be ridiculous. Mr. Romano asked whether the business had to pay for those ten years, and Mayor Golding said that the business did receive bills that covered the ten-year period.

Mr. Romano asked whether Mayor Golding recalled Council member Christine Kehoe stating that the rates were unfair to individuals. Mayor Golding responded that she recalled that there was a concern that if the rates were changed to help businesses then individuals users would be hurt. Mr. Romano asked whether Mayor Golding ever became aware that City was not in compliance with State law relating to the amount of biological materials deposited into the system, and Mayor Golding stated that she did not recall learning about such non-compliance. Mr. Romano asked if Mayor Golding would have been concerned if she had been told that the City would lose loans for being out of compliance, and she stated that she would have been. Mr. Romano asked if she would have recalled being told about such a possible consequence of non-compliance, and she said that she would have.

### *Meet and Confer*

Mr. Romano asked Mayor Golding whether the issue of contributions to the pension arose in Meet and Confer. Mayor Golding stated that the only time contributions to the pension arose in Meet and Confer occurred when the City Manager made recommendations and the Council would ask questions. She explained that the City Manager, not the Mayor, selected the people who negotiated the benefits on behalf of the City because the Charter required it. She stated that there was only one instance when the Council voted for the Mayor to take action on something that the Charter said was the City Manager's responsibility, but she did not state what that was until later in her interview (*see* "Ballpark Financing").

Mr. Romano asked about the interaction between the labor unions and the Council. Mayor Golding explained that sometimes labor unions would contact Council members during Meet and Confer in order to lobby, and sometimes Council members or their staff would meet with those union representatives. She learned when she was a Council member that it was important to hear from labor unions and what they are arguing for prior to the open voting session. Mayor Golding recalled being on the Council and learning from the head of the Police Officers' Association, only after the Council had approved a benefit, that the Council had voted to remove benefits for police officers' widows and she was shocked.

Mr. Romano asked whether Mayor Golding would have been involved in Meet and Confer if it concerned retirement enhancements. Mayor Golding said that the City Manager dealt with all of the Meet and Confers and first made a recommendation to Council in closed session. Mr. Romano asked if she recalled any controversy related to retirement enhancements being discussed in Meet and Confer, and she said that she did not. Mayor Golding explained that the Council's and Mayor's concern was to make the pension fund healthy.

### *Mayor Golding's Appointments to the CERS Board*

Mr. Romano asked whether Mayor Golding knew Diane Shipione. Mayor Golding stated that she had nominated some members of CERS Board, including Ms. Shipione and Ann Parode. Mr. Romano asked how Mayor Golding met Ms. Shipione. She stated that Ms. Shipione had been recommended to her, and she knew Ms. Shipione's husband Pat Shea for many years because Mr. Shea worked on Mayor Golding's campaign for the Board of Elections. Mayor Golding said that she had appointed Mr. Shea to be the chair of the Baseball Task Force when the Padres wanted a new ballpark because he was very independent and outspoken. Mr. Romano asked what was the purpose of the Baseball Task Force. Mayor Golding stated that the Baseball Task Force provided an independent review of the Padres' financial claims to determine whether the team really needed the new ballpark. The Padres made their books available to the Baseball Task Force to help them accomplish their task. Mayor Golding went on to state that she did not recall whether it was she or someone on her staff who interviewed Ms. Shipione. She also did not remember talking with Ms. Shipione before her appointment, but she did meet her at some point.

Mr. Romano asked how Mayor Golding choose people to sit on the CERS Board. Mayor Golding responded that she looked for independent people with real financial backgrounds who would make good decisions about the retirement fund, would be interested in the successful operation of the fund, and would be able to spend time dealing with issues that came before the Board. She added that she or her staff told every member of the Board who she appointed that they were expected to remain independent and to keep her appraised about what was occurring with CERS. Mr. Romano asked whether Mayor Golding recalled any conversations about the pension fund with her Board appointees, but she stated that she did not. Mayor Golding also mentioned that she did not go out socially with her Board appointees because she had no social life while she was the Mayor.

### *City Manager's Office*

Mr. Romano asked whether Mr. McGrory was the City Manager when Mayor Golding took office, and she confirmed that he was. Mr. Romano asked how well Mayor Golding knew Mr. McGrory. She stated that she knew him because he had been part of the City staff for 20 years, but she did not know him well and did not recall working with him previously. Mr. Romano then asked if a Mayor could take action if she was unhappy with the City Manager. Mayor Golding responded that a Mayor could take action if there are four other Council members who also are dissatisfied with the City Manager. Five members of the Council, which can include the Mayor, are needed to remove the City Manager. Mr. Romano asked if she worked with Mr. McGrory upon taking office. Mayor Golding responded that Mr. McGrory worked very hard with her when she arrived; they had a good working relationship. When Mr. Romano asked for Mayor Golding's impression of Mr. McGrory, she stated that she had a positive impression of him when she entered office and that she enjoyed working with him because he was intelligent and wanted to get things done.

Mr. Romano asked Mayor Golding why Mr. McGrory left office. Mayor Golding guessed that he left because he had received a great offer. She stated that Mr. McGrory had told her that he would stay until the end of her term, but then changed his mind. Mr. Romano then inquired about how Mr. McGrory's successor was chosen. Mayor Golding explained that the City hired outside consultants to bring in a new City Manager. She noted that she was not generally happy with the quality of candidates because most of them had no experience running a major city. Mayor Golding did like one of the candidates, but only she and one other Council member voted for him. Mr. Romano asked why the other Council members did not vote for him, and Mayor Golding replied that they had different opinions about him and she could not elaborate more because it was a discussion that took place in a closed session Council meeting.

Later in the interview, Mr. Romano asked Mayor Golding's opinion of Mr. Uberuaga. She stated that Mr. Uberuaga was a hard-working, honest, public servant. However, he had trouble running the City because there was a big difference between his previous job, being the manager of Huntington Beach, and managing San Diego. Mayor Golding noted that Mr. Uberuaga was not her first choice for City Manager.

### *MP-1*

Mr. Romano asked Mayor Golding whether she had conversations with Mr. McGrory about MP-1 prior to its enactment. Mayor Golding responded that she did not recall any conversations with Mr. McGrory about MP-1. She generally docketed the City Manager's recommendations, and she would have just docketed his recommendation to approve MP-1. Mr. Romano asked whether she recalled any conversations with Mr. McGrory about MP-1 after it had been enacted, and she stated that she did not.

Mr. Romano then explained MP-1 to Mayor Golding, but Mayor Golding stated that MP-1 did not sound familiar to her. Mr. Romano questioned whether the City Manager would sit down with Mayor Golding and explain matters that were complicated and important to her. Mayor Golding stated that because she voted on so many matters, she would have spent a lot of time on a matter that she proposed, but if the matter was administrative and not controversial at the time she would have only been briefed. Mr. Romano asked if there were restrictions on the types of questions Mayor Golding could have asked the City Manager about his recommended actions, and she stated that there were none. Mr. Romano asked whether Mayor Golding recalled a controversy surrounding MP-1, and she stated that she did not. She also noted that MP-1 was administrative in nature.

Mr. Romano next asked whether Mayor Golding recalled questioning Mr. McGrory about MP-1. Mayor Golding responded that she did. However, she also stated that her experience was that both the City and County retirement boards were conservative. Mayor Golding also noted that she felt okay about approving MP-1 because the City Attorney signed off on it, the CERS Board approved it, and the Council asked quite a few questions about it. In addition, Mayor Golding stated that when she asked for Mr. McGrory's assurance that MP-1 in no way jeopardized the pension fund, he answered that it would not because MP-1 contained a "failsafe."

Mr. Romano then showed Mayor Golding a June 28, 1996 memorandum from Mr. McGrory to Mayor Golding and the Council (Exhibit 3) and inquired whether Mayor Golding had asked Mr. McGrory why the City would be implementing MP-1. Mayor Golding responded that MP-1 did not derive from her and the Council. She stated that when MP-1 came through to the Council via the City Manager, she and the Council members previously had not seen it. Mayor Golding explained that MP-1 related to Meet and Confer and was administrative, which was under the purview of the City Manager. Mr. Romano asked whether she and the Council could talk with Mr. McGrory's staff about MP-1. Mayor Golding responded that in general, Mr. McGrory was open about letting his staff talk to the her and the Council. She also stated that she would have been surprised if a member of her staff was not permitted to talk with a department head under Mr. McGrory. She did not recall the ability of her staff to have such a conversation as being a problem, although she would not necessarily have known if it was. Mayor Golding did state that City Managers other than Mr. McGrory did forbid the Mayor's staff from talking with heads of departments.

Mr. Romano asked how MP-1 was presented to Mayor Golding and the Council. Mayor Golding responded that MP-1 was presented as a safe plan that would help the City financially. She also said that MP-1 already had been approved by the CERS Board prior to it being presented to her and the Council. Mr. Romano asked if anyone on the CERS Board came to her or a member of her staff to say that MP-1 was problematic. Mayor Golding responded in the negative and said that she would have remembered such a conversation. Mr. Romano then asked whether Mayor Golding recalled any discussions about MP-1. She responded that she remembered discussing in closed session and subsequently in open session that MP-1 was a complicated plan but it had a failsafe. Mr. Romano then asked whether Mayor Golding remembered if MP-1 was tied to benefits. She replied that she had almost no memory of MP-1 at all. She did not recall benefits being talked about in connection with MP-1, but noted that it could have been. She stated that benefits were discussed as part of Meet and Confer.

Mr. Romano showed Mayor Golding a June 21, 1996 memorandum from Mr. McGrory to the CERS Board that had been attached to Mr. McGrory's June 28, 1996 memorandum to Mayor Golding and the Council (Exhibit 4) and asked whether she read all of it. Mayor Golding responded that either she or her staff would have read it. Mr. Romano asked whether anyone on her staff was a pension expert, and she said that no one was. Mayor Golding then said that "to be blunt," you could not pay people to serve on her staff because of the state of the City government at that time. She also noted that the professional expertise was housed under the City Manager and she and her staff were criticized if they went above that expertise. Nevertheless, Mayor Golding added that, in general, everyone on her staff was supposed to talk to Mr. McGrory's staff. She also had hoped that the people she had nominated to the CERS Board would call Mr. McGrory's staff if they did not understand an action he was taking and would keep her in the loop. Mr. Romano asked whether the CERS Board members she appointed kept her informed, and she stated that they did sometimes call her staff.

Mr. Romano next asked whether Mayor Golding gave anyone on her staff the task of following MP-1, and she stated that she did not. He asked if anyone was supposed to follow retirement issues in general; she also did not recall anyone getting assigned to keep track of those issues. Mayor Golding said that if someone was assigned to the retirement issues, it would have been her Chief of Staff who did the assigning. Mr. Romano asked who her Chief of Staff was at the time of MP-1, and she responded that it was probably Ben Haddad in 1996 and Richard Ledford before him. Mr. Romano noted that it sounded as if Mayor Golding and her staff were somewhat at the mercy of the City Manager, and she agreed. She stated that she needed to ask the City Manager to get information and she needed to know to ask for that information. Mayor Golding stated that MP-1 would not have been passed without questions. Mr. Romano asked why San Diego had a City Manager. Mayor Golding responded that the City wanted professional management.

Later in the interview, Mr. Romano asked Mayor Golding whether the Council understood MP-1, and Mayor Golding stated that she did not know. Mr. Romano pointed out that Mr. McGrory stated in his interview with the Audit Committee that MP-1 involved a lot of public debate over a period of years. Mayor Golding responded that she was sure that MP-1 took time to get approved, but that those debates were not a part of hers or the Council's involvement with MP-1. She explained that they would not have been aware of MP-1 unless the CERS Board, the City Manager, or someone else brought it to their attention. When MP-1 was brought to her and the Council's attention, it was presented as being better for the City which interested her, and she is sure that it captured the interest of the Council as well.

At another point in the interview, Mr. Romano showed Mayor Golding an October 10, 1996 memorandum from Mr. McGrory to her and the Council forwarding CERS fiduciary council Dwight Hamilton's September 19, 1996 letter to Lawrence Grissom (Exhibit 5). Mr. Romano noted the handwritten note on Mr. McGrory's memorandum that stated "to Mayor and Council only, <u>not</u> full distribution" (emphasis in original), and asked whether Mayor Golding recognized the writing. Mayor Golding stated that she did not know whose handwriting that was. Mr. Romano then showed Mayor Golding Mr. Hamilton's letter and asked whether she knew why his opinion had been requested. She stated that she did not know why Mr. Hamilton wrote that letter and noted that the letter did not look familiar to her. Nevertheless, just because she did not recall seeing the letter did not mean that she never received it. Mr.

Romano asked what happens to mail that is directed to Mayor Golding from the City Manager. Mayor Golding responded that normally such correspondence goes to her staff first, unless Mr. McGrory walked it down to her or put a note on it that it should go directly to her. Mr. Romano asked what the handwritten note on Mr. McGrory's memorandum meant. Mayor Golding stated that it could have meant that the memorandum was only supposed to be delivered to her and the Council members, but not to their staff.

Mr. Romano referred Mayor Golding to page five of Mr. Hamilton's letter in which he addressed the question of the CERS Board's possible conflict of interest in approving MP-1. Mr. Romano also noted that Mr. Hamilton's opinion stated that the Board members did not have a conflict of interest when they voted for MP-1, and asked Mayor Golding if she recalled the fiduciary counsel's opinion being an issue. Mayor Golding responded that although she recalled some discussions about MP-1, she did not necessarily recall Mr. McGrory's memorandum attaching Mr. Hamilton's letter. Mr. Romano then asked if Mr. Hamilon's letter was repeating an issue that had been the subject of a public CERS hearing. Mayor Golding responded that she only recalled that some Board members and the City Manager periodically raised questions about the membership of the retirement board. She explained that there was a lack of ease with some members who were particularly aggressive about protecting the employee benefits. Therefore, when she made appointments to the Board, she tried to choose people who were independent. She noted that the labor presidents had a lot of influence over the Board.

Mr. Romano then asked what Mayor Golding's impression was of Ron Saathoff. She stated that Mr. Saathoff was very knowledgeable, a very strong advocate and a very influential person. Mr. Romano asked whether Mayor Golding ever tried to change the composition of the CERS Board. Mayor Golding responded that there was no way she could change the composition of the Board for political reasons. There had been more than one discussion about whether labor union presidents could sit on the Board, and Mayor Golding noted that she was uncomfortable with such an arrangement. Mr. Romano then stated that Mr. McGrory had said to the Audit Committee that he recalled times when he had been in a Meet and Confer and Mr. Saathoff would say that Mr. McGrory should go to the CERS Board meeting if he wanted to discuss retirement benefits. Mayor Golding responded that she was uncomfortable with the amount of influence labor unions had over the CERS Board and that this produced a feeling of a lack of independence. Mr. Romano asked whether she would have had a preference for an all independent CERS Board. Mayor Golding stated that she would, but it was not politically viable to create one. She also added that she personally liked Mr. Saathoff.

Mr. Romano commented that Mr. Saathoff was receiving benefits based on both his union and City salaries. Mayor Golding stated that she disagreed that Mr. Saathoff should collect his benefit based on his City and union salaries. She said that there was a lawsuit involving Mr. Saathoff and the City, but the City lost. She was unclear whether that lawsuit involved Mr. Saathoff's benefits being a combination of his City and union salaries. Mr. Romano asked how the City Council felt about union presidents having positions on the Board. Mayor Golding responded that she could not recall the specifics, but a minority of the Council members felt that the union presidents on the Board were overreaching and inappropriate. Mayor Golding added that the manner in which Mr. Saathoff was getting paid was inappropriate.

Later in her interview, when she was discussing her thoughts on remediation. Mayor Golding stated that she did not think MP-1 underfunded the pension system when she was the Mayor. She noted that at that time the funded ratio of the system was over 90 percent and therefore the underfunding had not been brought to her attention as being a problem. Mr. Romano then stated that the Audit Committee had been told that MP-1 assumed that there would be no more increased benefits without the adjustment of MP-1. Mayor Golding responded that when she ran for Mayor, she did not have the support of the unions because she believed in the competitive bid. She also stated that after she was elected she did not hesitate to cut salaries. Consequently, Mayor Golding never felt that the City had to give benefits they could not afford. She noted that she fought the agency-shop form of government because it resulted in giving up the ability to control costs. Mr. Romano then asked Mayor Golding's impressions of the unions. She responded that there are good people in the unions, but that it is the job of the labor union leaders to get the most money for their people.

### *Post-Retirement Health Care*

Mr. Romano asked whether Mayor Golding recalled changes in the retiree healthcare insurance. She responded that she recalled a change limiting the health insurance to an HMO. Mr. Romano then asked whether she remembered how the retiree healthcare insurance got moved to CERS, and she said that she did not. Mr. Romano then explained how the retiree healthcare was going to be paid out of CERS's excess earnings as opposed to paying it out of other funds on an actuarial basis. Mayor Golding stated that she recalled hearing about that change but not whether it had been discussed with her.

### *City Attorney's Office*

Mr. Romano asked Mayor Golding who the City Attorney was when she served as Mayor. Mayor Golding said that Casey Gwinn probably was elected as the City Attorney in 1996, and before him John Witt held that position. Mr. Romano asked whether she supported either Mr. Witt or Mr. Gwinn in their elections to City Attorney. Mayor Golding did not recall supporting either of them, but said that she knew Mr. Witt when she was a Council member.

Mr. Romano asked whether Mayor Golding and her staff interacted with the City Attorney's Office. Mayor Golding responded that she and her staff dealt with the City Attorney's staff and Assistant City Attorneys. She also added that Leslie Girard briefed her a lot on the issues, and before that Mr. Witt would brief her. Most of the time, Mayor Golding dealt with Mr. Girard. Mr. Romano asked if Mayor Golding would rely on the City Attorney's opinions. She responded that it was not unusual for her to rely on the City Attorney's recommendations because the City Attorney was elected by the citizens. However, if she knew enough to question the City Attorney's opinion, outside counsel could be hired, but that would be expensive.

Mr. Romano asked Mayor Golding to explain the difference between Mr. Witt's and Mr. Gwinn's administrations. She stated that a lot of the same people from Mr. Witt's administration worked under Mr. Gwinn. Mr. Witt and Mr. Gwinn were very different people. Mr. Witt had been municipal lawyer for years while Mr. Gwinn had been prosecutor for years and had a passion for domestic violence work. Mr. Romano asked whether Mayor Golding's office consulted with Mr. Gwinn on domestic violence, and she stated that she did not think that her staff did consult with Mr. Gwinn a lot on that issue.

### *Ballpark Financing*

Mr. Romano asked whether a big item on Mayor Golding's agenda was the Padres' new ballpark (the "Ballpark"). She responded yes, but said that it was not by choice that the Ballpark became a big issue of hers. Mayor Golding explained that the Padres said they would have to leave the City if they did not get a new ballpark, and that was a big public issue. The Padres' old ballpark was one of the oldest stadiums in the country. When John Morse bought the Padres, he thought that the City would build a new stadium for the Padres, but he never bothered to ask.

Mr. Romano noted that Mayor Golding's second term ended in 2000 and asked how the Ballpark issue evolved. Mayor Golding responded that the Padres' need for a new ballpark was not in her State of the City address. She explained that the Padres were great at public relations, and there was a lot of pressure on her and the Council to make sure the Padres did not leave the City. She met with Mr. Morse and gave him an estimate of five years to complete the building of the new stadium. Mr. Morse was angry because he thought the Ballpark would be completed sooner and would cost less than she had projected. Mayor Golding said that she thought that because the Ballpark was a new public facility that would cost a lot of money to build it had to be voted on by the citizens.

Mr. Romano asked how the Ballpark would be financed. Mayor Golding responded that it was supposed to be paid for out of the City's General Fund, and the Padres were responsible for any cost above what the General Fund would cover. She also noted that the Padres fought against the idea of creating a special tax to pay for the Ballpark. Mayor Golding explained that in order for the Ballpark to be approved, there needed to be a two-thirds vote of the citizens which would have been unlikely if a special tax was required. Thus, the issue became whether the City could afford to pay for the Ballpark out of the General Fund. She stated that when the voters approved the Ballpark project they did not vote on where the funds would come from. Mr. Romano asked whether the City had the money in the General Fund to build the Ballpark, and Mayor Golding stated that the City did. She explained that there had been a public discussion on how the Ballpark would be funded. The voters approved the Ballpark by a substantial percent (about 60 percent) even though the City had not run a campaign to get this accomplished. Mr. Romano asked who ran the negotiations on behalf of the City. Mayor Golding explained that since the Padres were not getting anywhere with the City Manager, the Council, not at her request, made a motion that the Charter be changed so that she would head the negotiations.

Mayor Golding stated that Mayor Dick Murphy floated the bonds for the Ballpark. Mr. Romano then asked Mayor Golding to confirm that indeed some of the money for the Ballpark would come from bonds, and she did. Mayor Golding explained that she would have worked on the Ballpark bonds, but there was a controversy regarding Councilwoman Valerie Stallings' involvement with the Ballpark bonds. Mr. Romano asked whether some of the City money to pay for the Ballpark did not come from the General Fund, and Mayor Golding stated that was correct. She said that some of the funds came from the CCDC (the Centre City Development Corporation). Mayor Golding explained that the CCDC was involved because having a vital downtown area was very important to City finances as the revenue produced there would be used to help the rest of the City.

### *Corbett*

Mr. Romano asked whether Mayor Golding knew anything about the *Corbett* lawsuit that had been brought against the City. Mayor Golding said that she recognized the name Corbett and that the City essentially lost that case. She added that she had been surprised and frustrated that the case did not come down in the City's favor because she understood from the City Attorney's Office that the City had a financially and legally sound case.

Mr. Romano then showed Mayor Golding a slide presentation on the *Corbett* case (Exhibit 6). Mayor Golding stated that she recalled that *Corbett* cost the City and affected numerous municipalities. Mr. Romano asked whether she remembered that the *Corbett* settlement required that the pension remain 90 percent funded. She did not recall, but said that did not mean that provision was not included in the settlement.

Mr. Romano then showed Mayor Golding an April 13, 2000 memorandum from Bruce Herring to Mayor Golding and the Council (Exhibit 7) and noted that the memorandum appeared to suggest that the funded ratio had to be calculated in a certain way to make the pension 90 percent funded. Mayor Golding stated her belief that prior to the *Corbett* case the pension was over 100 percent funded. In fact, she recalled that the entire time when she was Mayor the pension was well funded. She also remembered being told at one point that the funded ratio was over 105 percent and that the City was not allowed to have it be over 100 percent. Mayor Golding added that no one ever told her that there was a problem with the funded ratio. Mr. Romano asked why she was sent Rick Roeder's (CERS actions) valuation, and Mayor Golding stated that she did not know and noted that she got thousands of pages of paper. Mayor Golding did state her knowledge that the *Corbett* settlement brought down the funded ratio.

### *Remediation*

At the end of the interview, Mr. Romano asked Mayor Golding her thoughts on remediation. She stated that the City should not spend money that it does not have. Mayor Golding said that the City should get the pension funded ratio back to where it had been, have a payment plan, and be honorable about it. She added that the City will never be flush because of taxes, and noted that the City is treated very unfairly by the State in its use of property taxes as a result of a political legislative decision after Proposition 13. Mayor Golding stated that San Diego cannot be compared to New York City when thinking about remediation.

W.F.G.

3269848

# EXHIBIT 1

The City of San Diego

# MANAGER'S REPORT

DATE ISSUED: June 19, 1996 REPORT NO. 96-131

RECEIVED
96 JUN 17 PM 7:33
CITY CLERKS OFFICE
SAN DIEGO, CA

ATTENTION: Honorable Mayor and City Council, Docket of June 24, 1996

SUBJECT: Reduced Water and Sewer Capacity Charges

REFERENCE: City Manager's Report No. 96-97, issued April 19, 1996

SUMMARY

Issue: Shall water and sewer capacity charges (developer fees) be reduced?

Manager's Recommendations:

1. Direct the City Manager to a) reduce water capacity charges from $4,012 to $2,500; and b) reduce sewer capacity charges from $6,998 to $2,500; and c) reduce water and sewer capacity charges to $1,500 each ($3,000 combined) per equivalent dwelling unit (EDU) for commercial and industrial business enterprises meeting the revenue and job-generating criteria contained in Council Policy 900-12, for affordable housing units (defined as units planned to be occupied by and affordable to families earning no more than 65% of median area income adjusted for family size as certified by the San Diego Housing Commission), and for new residential construction in City approved redevelopment areas; and d) make these reductions retroactively effective as of April 22, 1996, with appropriate reimbursement to ratepayers who paid at the higher levels subsequent to that time.

2. Direct the City Manager to develop financing plans that incorporate these reduced capacity charges with offsetting reductions in projected operating and capital budgets.

Other Recommendations:

In February 1996, Mayor Golding requested that staff evaluate the current level of capacity charges. On April 22, 1996, the Committee on Rules, Finance and Intergovernmental Relations supported reducing water and sewer capacity charges provided service fees would not have to be increased. An additional reduction would be provided for commercial and industrial business enterprises meeting the revenue and job-generating criteria contained in Council Policy 900-12 and for affordable housing projects.

R-287543

On May 29, 1996, the Committee on Land Use and Housing supported reducing water and sewer capacity charges for affordable housing below the rates charged for residential housing, and recommended including all residential housing in redevelopment areas at the same reduced capacity charge as affordable housing.

Fiscal Impact:

Estimated revenue loss to the Water Fund is approximately $6.2 million per year; estimated revenue loss to the Sewer Fund is approximately $15.6 million per year.

## BACKGROUND

Capacity charges are generally due at the time of permit issuance and represent advance contributions of a new user's share of the anticipated cost to construct expanded water and sewer facilities required to meet increased system demand. Current City of San Diego capacity charges per EDU are $4,012 for water and $6,998 for sewer.

In an effort to promote economic development, the City Council established a policy effective in January 1995 to allow reductions of water and sewer capacity charges to $2,500 each ($5,000 combined) per EDU and negotiated payment schedules for commercial and industrial business enterprises meeting the revenue and job-generating criteria contained in Council Policy 900-12.

In December 1996, $350 million of City Council approved sewer revenue bonds were sold with a published pro-forma revenue stream that incorporated the operative $6,998 per EDU charge.

On April 22, 1996, the Committee on Rules, Finance and Intergovernmental Relations directed the City Manager to develop financing plans that incorporated reductions in the water and sewer capacity charges to $2,500 each and incentivized charges of $1,500 each for those qualifying for Council Policy 900-12 criteria and for affordable housing, with offsets for lost revenue being found in budget adjustments as opposed to compensating service charge increases.

## DISCUSSION

### Impact of Capacity Charges on the Current Business Environment

At a current combined rate of $11,010 per equivalent dwelling unit, capacity charges can represent a major up-front expenditure for businesses and developers or those making new construction decisions and unable to qualify for relief under Council Policy 900-12. Since economic decisions by the local construction industry are driven by many interrelated factors (perceived future demand, available interest rates, etc.), it is difficult to gauge the extent to which the levels of capacity charges influence these decisions. However, the current levels are among the highest in the nation (Table

1 attached) and are inconsistent with the City of San Diego's overall image as citizen and business friendly. It is therefore timely to lower capacity charges to the extent feasible and prudent.

Bond Market and Future Debt Service

Pursuant to City Council direction and as a means of mitigating the impact of large, mandated construction costs on ratepayers, a debt financing program was implemented in the sewer utility and is contemplated for the water utility. Because the City's water and sewer utilities are self-supporting enterprises which derive their income from the sale of capacity and the collection of monthly user charges, revenue losses associated with reductions in capacity charges will have to be offset by appropriate reductions in expenditures. To the extent that operating or capital expenditure reductions or deferrals are considered, the impact of such measures on the City's ability to meet existing legal mandates and to continue satisfying public safety and health concerns must be carefully evaluated prior to implementation.

With regard to the existing sewer revenue bonds, the City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Wastewater System which will be at least sufficient during each fiscal year to provide Net System Revenues equal to 1.2 times the Debt Service. Similar covenants are anticipated for future water revenue bonds. A higher ratio is considered a positive indicator of financial health and management by credit rating agencies and investors.

Minimizing the cost and ratepayer impact of borrowing depends to a large extent on maximizing the "credit quality" of the bonds issued as perceived by rating agencies and the market they serve.

Since they are based on the local construction economy, water and sewer capacity charges are considered to be a volatile and unreliable revenue source by the financial community. Reducing the City's reliance on them may enhance the marketability of the City's bonds and result in a lower cost of financing, as long as accompanying actions to compensate for reduced capacity charge revenue (such as appropriate reductions in operating costs) are adopted and closely monitored to assure their ongoing viability.

The City has earned a reputation for credible fiscal estimates and sound financial planning, consistently leading to positive credit ratings and lower debt service expenditures that benefit system ratepayers. Key to rating agency evaluations has been the willingness of the City to adhere to bond covenants and the terms of the other bond documents. In particular, Moody's Municipal Credit Report (November 28, 1995) with regard to the City's December $350 million sewer fund bond issue, stated in part:

> "Coverage levels are expected to decline from 5.09 in fiscal 1995 to 1.26 in 2000. The sharpness of this decline and the city's plans to rely largely on capital grants and connection fees to meet its rate covenant during this period raise concerns about the adequacy of future coverage and that rate increases may need to be higher than planned. But these concerns are

offset by the conservative assumptions underlying the forecasts and the city's demonstrated willingness to raise rates as needed."

Rating agencies will continue to carefully review City Council actions and reassess credit worthiness as it relates to future bond issues.

Implementation Analysis

An analysis has been completed that identified prudent measures to compensate for decreases in projected capacity charge revenues. The key changes in Water and Sewer Financing Plan assumptions over the planning horizon (through fiscal 2003) to offset reduced capacity charge revenues include lower future inflation (3% through fiscal 2000 and 4% thereafter instead of 5% each year), lower future bond rate assumptions (6.5% instead of 7%) and projected budget reductions. The economic changes were made in acknowledgment of recent trends and a newly released Federal Reserve Bank of Philadelphia report ("The Livingston Survey"). Table 2 (attached) depicts the estimated offsets through the FY 2003 planning horizon and provides additional detail for FY 1997 budget reductions.

CONCLUSION

In concert with other City actions to create a business friendly environment and stimulate the development of affordable housing, the reduction of water and sewer capacity charges may act to encourage local economic health. An appropriate reduction in capacity charges is recommended to be implemented and incorporated in the revised Financing Plans.

ALTERNATIVES

1. Choose to retain current capacity charges and related policies. This decision would rely on other Council actions and the normal business cycle to stimulate the local economy.

2. Consider the elimination of capacity charges in general, shifting the entire burden of development-related utility infrastructure funding to current system users. This is not recommended because of its adverse impact on water and sewer user charges, safe operations and/or timely system repair and maintenance.

Respectfully submitted,

JACK McGRORY
City Manager

# EXHIBIT 2

# CITY OF SAN DIEGO
# MEMORANDUM

**DATE:** October 6, 1999

**TO:** Honorable Mayor and City Council

**FROM:** George Loveland, Deputy City Manager

**SUBJECT:** Water and Sewer Cost of Service Studies

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Transmitted herewith for your information and review are copies of the Water and Sewer Cost of Service Studies which were undertaken during late FY 1997 and FY 1998 as a part of the rate analysis process.

The studies, which were performed by the consulting team of Pinnacle One and Chester Engineers, were utilized by staff to insure that the then-existing and proposed rate structures for the water and sewer utilities were consistent with the requirements of Proposition 218, and to identify alternative approaches which could be considered if the need arose.

Our conclusion, based on the studies and extensive internal review, was and is that the water and sewer rate structures adopted by the Council are both business-friendly and consistent with the requirements of Proposition 218. This being the case, no changes are needed or recommended at this time.

Should you or your staff have questions with respect to the Studies, please let me know.

GEORGE LOVELAND
Deputy City Manager

DHK

# CITY OF SAN DIEGO
# SEWER COST-OF-SERVICE REPORT

PREPARED FOR: CITY OF SAN DIEGO
FINANCING SERVICES
202 C STREET, MS-7B
SAN DIEGO, CALIFORNIA 92101

PREPARED BY THE TEAM OF: PINNACLEONE
CHESTER ENGINEERS

MAY 14, 1998

MWWD-BH0950

6-30-05 COS SEC Subpoena

WASTEWATER0002665

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# CITY OF SAN DIEGO
# SEWER COST-OF- SERVICE REPORT

## I. EXECUTIVE SUMMARY

Purpose of the Report.

The purpose of this report is to determine the costs of providing wastewater collection, conveyance, and treatment services to the City of San Diego and the Participating Agencies outside the City and to establish rates based on those costs. Operation, maintenance, and replacement (OM&R) costs, debt service costs, and costs for planned capital improvements were allocated to the cost-causative components of the wastewater system and were divided by the total plant loadings to determine unit costs for flow, suspended solids (SS), and chemical oxygen demand (COD). The contribution of each user or user class was then multiplied by the unit cost for each parameter to establish a sewer rate in proportion to the user's demand on the system. The procedure used in preparing this report meets with the requirements of the State Water Resources Control Board (SWRCB). Cost information from this report will be used to prepare the Wastewater System Revenue Program that must be submitted to the SWRCB for approval.

City's Current Billing System and Changes to be Made.

The City's current system bills sewer customers within the City based on their flow and suspended solids contributions to the system. However, the organic strength of the sewage is not factored into sewer bills for City customers. Participating Agencies in the Metropolitan sewer system are billed on the basis of flow, suspended solids, and organic strength. The costs of providing wastewater collection, conveyance, and treatment services to the City of San Diego and the Participating Agencies in total based upon flow, suspended solids, and organic strength are determined so that all of the entities pay their "fair and equitable" share for collection, treatment, and disposal/reuse of the total wastewater flow, including suspended solids content and organic strength loading.

Changes are made so that costs are allocated within the City to individual customer classes so that the revenue generated by each user class is in proportion to the customer's demand on the system. Annual revenue requirements for the Metro wastewater system and the City's Municipal (Muni) wastewater system through 2003 were provided by the City for use in determining rates that would be charged to users that reflect their contributions to flow, suspended solids and organic strength.

The report includes the:

- Executive Summary,
- Introduction,
- Summary of the SWRCB requirements for revenue programs including the procedures to be used in developing a revenue program,
- A description of the wastewater system that serves the City of San Diego and the Participating Agencies (see subsection IV.F for the definition of Participating Agencies) and the organizational structure of the department that oversees the operation of the sewer

system. Information is presented on current sewer system customers and classifications, the capital improvement program for the system, and a summary of the service agreements between the City and Participating Agencies,

- OM&R and debt service costs are projected based on current operations and planned system improvements,
- Expenses are allocated to the cost-causative components, resulting in unit costs for the treatment parameters of flow, SS, and COD. The unit costs are allocated to individual customers or customer classes based on the relative contribution of each customer to the system.

SWRCB.

The SWRCB developed Revenue Program Guidelines to assist local governments and public agencies in preparing, implementing, and maintaining revenue programs that comply with Section 204(b)(1) of the Federal Clean Water Act, Federal and State Regulations and Policies of the State Water Resources Control Board (SWRCB). These Guidelines apply to all recipients of wastewater system grants and loans from the U.S. Environmental Protection Agency (EPA) and the SWRCB.

The City of San Diego, as a previous recipient of EPA Construction Grant Program moneys, is required to comply with Appendix B of 40, Part 35, Subpart E of the Federal Regulations. Adopting a user charge system based on strength-based billing is not only a condition for retention of previously awarded grant funds under the EPA program, but it is a requirement for future funding under California's State Revolving Fund for Construction of Wastewater Treatment Facilities. MWWD is presently pursuing low/no interest loans under the state revolving fund program.

The Wastewater System.

The Wastewater System consists of the Municipal (Muni) System, which is a municipal sewage collection system for the City's residents, and the Metropolitan (Metro) System, which is a regional sewage collection, treatment and disposal system initiated in 1958 (and operational since 1963) to serve the City and various other public agencies including cities situated within common drainage areas. The Metro System was designed to provide sufficient capacity to accommodate a regional population of 2,600,000. The City, as owner and operator of the Metro System, is the holder of the National Pollutant Discharge Elimination System (NPDES) permit and is responsible for maintaining the discharge requirements required under Federal law.

The Metropolitan Wastewater Department (MWWD) manages the Metro system and assumed responsibility for the Muni system on July 1, 1996. The wastewater system is operated with funds derived primarily from sewer service charges. All system revenues are deposited in the Sewer Revenue Fund, which is used to finance operation, maintenance, replacement, and capital improvements in both the Metro and Muni systems. As an enterprise fund, the Sewer Revenue Fund is held separate and apart from other funds of the City.

Wastewater generated by the Participating Agencies (see subsection IV.F for the definition of Participating Agencies) is metered as it enters the Metro system and charges for treatment are based on flow, SS, and COD. Within the City, wastewater flows from individual locations are not measured and metered water consumption is used to approximate each customer's sewage flow.

The Metro system serves the City of San Diego and fourteen Participating Agencies located outside the City. Within the City, sewer customers are grouped into the following four major classifications:

| Description | Total Customers (Connections) |
|---|---|
| Single family dwelling | 198,979 |
| Other domestic (multiple living units) | 29,340 |
| Commercial | 19,146 |
| Industrial | 596 |

OM&R Costs and Allocation Methodology.

The wastewater system OM&R cost information was collected from City and MWWD financial reports. This information was summarized and allocated to the cost centers. The three operating cost centers are (1) Municipal System ("Muni"), Fund 41506, (2) Metro Projects ("Metro"), Fund 41508, and (3) Metropolitan Wastewater Plan ("Metro" or "Metro New Construction"), Fund 41509. Within each fund are a number of departments. The total OM&R costs for each department were determined so the costs could be allocated to the different treatment parameters.

Capacity Fees.

Capacity fees are imposed on developers of real property as a means of recovering all or part of the cost of constructing plants or other facilities necessitated by growth. Capacity fees are not to be confused with connection fees, which are charges for time and materials necessary to connect property to the system. Three levels of capacity fees are described and modeled in this report:

1. No capacity fee. All costs and expenditures would be recovered via monthly service charges and other charges such connection fees.

2. A full cost recovery fee. All cost of expansion would be borne by new development.

3. A fee set in between the two. This is the current method adopted by the City of San Diego.

The City currently imposes a capacity fee which only partially funds expansion of wastewater facilities necessitated by new development. In most cases, the fee is $2,500 per EDU of capacity required. Under certain circumstances, a reduced fee of $1,500 per EDU is charged.

A full cost recovery capacity fee would be computed by dividing the total cost of facility expansion by the units of new capacity created. The expansion program that began in 1988 will increase capacity from 219 million gallons per day to 277 million gallons per day in 2003; an increase of 58 million gallons per day. The cost of the expansion is $913.8 million in 1998 dollars. Expansion capacity is designed on the basis of 280 gallons per day per EDU. The fee is determined as follows:

The cost per unit of capacity would be $913,841,000/58,000,000 = $15.76 per gallon per day.

The single family capacity fee in 1998 would be $4,412 ($15.76 * 280) and this is the EDU. Other land uses would be related to the single family based on EDUs.

Capacity fees are collected on a pay-as-you-go basis which means that the funds needed for adding plant capacity are received over a period of years as development occurs. To construct capacity so it is available when needed, the City must borrow the necessary funds. Therefore, the capacity fee should be increased each year for increased construction and financing costs.

Strength Based Billing Rates for Fiscal Year 1998.

Monthly sewer bills for different types of customers within the City based on 1997 and 1998 rates under the City's current system are compared to the strength-based billing (SBB) rates for 1998 determined in this report. The 1998 SBB rates include charges for flow, SS, and COD, but do not include a base fee or a sewer cap based on winter water use. The SBB rate is a straight calculation using the flow, SS, and COD contributed by each customer times the respective unit cost for each parameter.

Table I-1 shows that SBB will increase sewer charges for commercial and industrial customers compared to the current system in which bills are based only on flow and SS. The largest rate increases will be experienced by customers that contribute significant amounts of COD to the system. In contrast, sewer bills for single family customers will generally decrease when the SBB system is instituted. Single family customers who use less than the average amount of water (14 HCF per month) will pay less than their current sewer bills. For example, a single family customer using 10 HCF per month would pay 44 percent less with SBB in 1998 than it would based on projected existing 1998 rates. At the same time, single family customers who use more than the average amount of water will get higher sewer bills with SBB.

Table I-2 shows the differences in SBB bills under the three different Capacity Fee alternatives. If the Capacity Fee is reduced from the current fee to no fee, the rates are increased by approximately 3.4%, and if the Capacity Fee is increased under a full cost recovery method, the rates decrease by approximately 3.1%.

## II. INTRODUCTION

### A. Purpose of Report

This sewer cost-of-service report was prepared to determine the costs of providing wastewater collection, conveyance, and treatment services to the City of San Diego and the Participating Agencies outside the City. Operation, maintenance, and replacement (OM&R) costs, debt service costs, and costs for planned capital improvements were allocated to the cost-causative components of the wastewater system and were divided by the total plant loadings to determine unit costs for flow, suspended solids (SS), and chemical oxygen demand (COD). The contribution of each user or user class was then multiplied by the unit cost for each parameter to establish a sewer rate in proportion to the user's demand on the system. The procedure used in preparing this report meets with the requirements of the State Water Resources Control Board (SWRCB). Cost information from this report will be used to prepare the Wastewater System Revenue Program that must be submitted to the SWRCB for approval.

### B. Scope and Content

This report allocates costs between the individual Participating Agencies and the City of San Diego so that all of the entities pay their "fair and equitable" share for collection, treatment, and disposal/reuse of the total wastewater flow, including suspended solids content and organic loading. Costs are further allocated within the City to individual customer classes so that the revenue generated by each user class is in proportion to the user's demand on the system.

The report includes an Executive Summary, Introduction, and five other main sections. Section III summarizes SWRCB requirements for revenue programs, including the procedures to be used in developing a revenue program. Section IV describes the wastewater system that serves the City of San Diego and the Participating Agencies and the organizational structure of the department that oversees the operation of the sewer system. The section also includes information on current sewer system customers and classifications, describes the capital improvement program for the system, and summarizes the service agreements between the City and Participating Agencies. Section V presents OM&R and debt service cost projections based on current operations and planned system improvements, while Section VI allocates these expenses to the cost-causative components resulting in unit costs for the various treatment parameters. In Section VII, the unit costs are allocated to individual customers or customer classes based on the relative contribution of each customer to the system. The Appendices and Exhibits referred to in Volume I of this Report can be found in Volume II.

### C. Assumptions

The primary assumptions used in preparing this report are as follows:

1. Annual revenue requirements for the Metro and Muni systems are based on historical cost information and cost projections developed by the Metropolitan Wastewater Department (MWWD) and the City's Financing Services Division. The City's Financing Services Division includes an annual

inflation rate for expenditures of three percent for Fiscal Years 1998 through 2000 and four percent for Fiscal Years 2001 through 2003.

2. Wastewater flow and load projections for the Metro system are based on an October 7, 1996, memorandum titled Wastewater Flow and Load Projections - 1997 Financial Plan, as prepared by the MWWD Technical Services Division.

3. Baseline sampling data from June 1995 through December 1996 was used to determine the chemical oxygen demand (COD) and suspended solids (SS) loadings produced by the individual Participating Agencies and the City as a whole. Flow weighted COD and SS concentrations were used to calculate the total pounds contributed by each entity.

4. COD was measured at sampling sites within the Metro system. The flow weighted average COD concentration for the City was higher than the average concentration for the Participating Agencies.

5. Operation, maintenance, replacement, and capital costs for the Metro system were allocated to the three treatment parameters of flow, COD, and SS using the functional-design approach developed for the MWWD by Montgomery-Watson in June 1996. The same functional-design approach was used to allocate Muni system costs to flow, COD, and SS.

6. The Muni and Metro system capital improvement projects are financed by both debt and pay-as-you-go funding. The amount of debt financing varies each year to accommodate cost needs and financing constraints. The amount of debt outstanding at any one time on the sewer system is limited to no more than 80 percent of the capitalized plant value.

7. Expansion-related capital improvement projects are partially funded by capacity fees.

## III. STATE WATER RESOURCES CONTROL BOARD REVENUE PROGRAM GUIDELINES

This section of the report presents the guidelines and requirements ("Guidelines") set forth by the State Water Resources Control Board (SWRCB) for sewer system revenue programs.

### A. General Requirements

The Revenue Program Guidelines were developed to assist local governments and public agencies (municipalities) in preparing, implementing, and maintaining revenue programs that comply with Section 204(b)(1) of the Federal Clean Water Act, Federal and State Regulations and Policies of the State Water Resources Control Board (SWRCB). These guidelines apply to all recipients of wastewater system grants and loans from the U.S. Environmental Protection Agency (EPA) and the SWRCB.

The City of San Diego, as a previous recipient of EPA Construction Grant Program moneys, is required to comply with Appendix B of 40, Part 35, Subpart E of the Federal Regulations. Paragraph f(1) of Appendix B states:

> The user charge system must result in the distribution of the cost of operation and maintenance of treatment works within the grantee's jurisdiction to each user (or user class) in proportion to such user's contribution to the total wastewater loading of the treatment works. Factors such as strength, volume, and delivery flow rate characteristics shall be considered and included as the basis for the user's contribution to ensure a proportional distribution of operation and maintenance costs to each user (or user class).

Adopting a user charge system based on strength-based billing is not only a condition for retention of previously awarded grant funds under the EPA program, but it is a requirement for future funding under California's State Revolving Fund for Construction of Wastewater Treatment Facilities.

A revenue program is a formally documented user charge system that is developed by the municipality. A user charge system is designed to provide a revenue source for wastewater system operation, maintenance, and replacement (OM&R) costs that satisfies federal and state requirements. Rates under a user charge system are set based on the number and type of identified users and their respective contributions to the wastewater loading of the treatment works.

In contrast, a service charge system includes the user charge OM&R costs, plus additional charges, if appropriate for the local agency, to cover capital related payments such as debt service costs and contributions to capital reserve accounts. A system of service charges is developed by estimating the municipality's annual revenue requirements for the total wastewater system OM&R, including those portions not grant or loan funded. Debt service, as well as revenue for capital reserve and operating reserve funds, may also be collected by the system of charges based on actual use or, if approved, by ad valorem taxes. The SWRCB recommends that funds for the cost of debt service, capital improvements, etc. also be collected in proportion to the costs of service rendered.

## B. Annual System Costs

Annual system costs for a wastewater system include OM&R costs and, in most cases, capital costs such as pay-as-you-go capital costs, debt service, and contributions to capital reserve accounts. Municipalities may also establish an operating reserve fund to ensure proper operation of the treatment works.

OM&R expenditures include the costs for labor, power, chemicals, supplies, laboratory control and monitoring, general administration, billing, and other miscellaneous expenses incurred during normal system operation. This category also includes expenses for ordinary repairs that are needed to keep the treatment works in proper operating condition, administrative costs such as overhead and accounting which are directly related to the OM&R of the system, and replacement costs as defined below. An estimate of future OM&R costs should be made by adjusting the most recent operating cost data to reflect projected operational modifications, wage increases, or staffing changes.

Replacement costs as defined by the SWRCB include all expenditures required for a facility to operate for its design life. This includes costs for items such as pumps, motors, electrical controls, telemetry equipment, air scrubbing equipment, chlorination equipment, dechlorination equipment, vehicles, radios, and other components which require periodic replacement. However, replacement costs do not include capital costs for major upgrades of individual process units, structural rehabilitation of existing facilities, expenses for plant expansions that are undertaken to meet future user demands, or costs to upgrade the treatment process. Replacement costs may be based on a minimum five-year planning cycle, and the annual replacement cost to be included in the user charge must be recalculated each year. In lieu of the five-year replacement plan, the municipality may deposit an amount in the replacement fund equal to the sum of the straight line depreciation of the replacement items based on their current costs, but excluding related structural facilities such as buildings, pipes, etc.

Debt service is the annual sum of the principal and interest payments on proposed or outstanding obligations that are secured by bonds or loan contracts. Although it is not required, municipalities are encouraged to establish an operating reserve fund to ensure proper operation of the treatment works. This fund is intended to satisfy costs associated with unexpected price increases, additional chemical or power usage, and other such items, but does not include costs for replacement of equipment. According to the SWRCB, wastewater agencies in California normally operate with reserves of between 10 and 50 percent of annual revenue requirements.

## C. Identification of Users

After the annual costs of the wastewater system are determined, the users of the treatment works and their associated wastewater flows and loadings must be identified. Flows and loadings must be documented for residential, commercial, institutional, and industrial user groups. Individual cost allocations do not have to be made for various types of residential users, but dividing residential users into single family, multiple family, or mobile home subgroups will allow more refined cost allocations to be made. Commercial and industrial users may need to be divided into appropriate subgroups that reflect the great variability in wastewater flow rates and strengths. Commercial or industrial users that discharge more than 25,000 gallons per day (gpd) to the system must also have their costs allocated individually. Similar to the commercial and industrial groups, costs must be allocated to individual institutional users or user groups such as hospitals, correctional facilities, schools, and colleges. The City of San Diego's user groupings and cost allocations comply with these requirements.

Any outside municipality that discharges to the treatment works must be listed as a separate user group. Additionally, if septage (septic tank discharge) is received by the treatment works, this category must also be listed as a user group with corresponding flows and loadings. The charges established for septage must be based on its contributing loadings. Generally, a 1,000 gallon dump from residential septic tanks contains 5,400 milligrams per liter (mg/L), or 45 pounds, of five-day biochemical oxygen demand (BOD), and 12,000 mg/L, or 100 pounds, of suspended solids (SS). Other types of septage from commercial and industrial sources must be sampled at the discharger's expense to prevent unacceptable discharges and to allow a proper charge to be calculated.

D. Procedures for Allocating Annual Revenue Requirements and Determining Rates

Allocating annual costs to the system users is a three-step process. The initial step is to allocate the cost among the treatment parameters in proportion to the percentage of costs that the flow, $BOD_5$, SS, and other components represent. The City of San Diego has requested in writing a variance to use COD rather than BOD. A written response was received on November 6, 1997 granting the variance. The second step is to divide the allocated costs by either total plant loadings or total design loadings to determine unit costs for each treatment parameter. The final step is to multiply each user's contribution to the system by the unit costs for each parameter to establish a sewer rate in proportion to the user's demand on the system.

OM&R costs for the treatment works must be recovered from system users through a user charge system that is based either on actual use or through a pre-approved ad valorem tax system. User charges must recover OM&R costs from users based on their proportionate contribution to the total wastewater loading from all system users. However, the total OM&R budget may be offset by income derived from the operation of the treatment works. This type of income can result from the sale of used equipment, sewage sludge, digester gas, reclaimed wastewater, treatment plant residues, or power generated from plant by-products. Investment income from assets of the wastewater enterprise is also considered operating income if the assets were originally funded with income generated from user charges.

If desired, a municipality may adopt reduced or less than proportionate share rates for low income residential users. A low income user is defined as any user whose income level is below the poverty rate established within the municipality's service area. If used, the reduced service charge must be based on an economic consideration only and may not be applied only to a subgroup under the poverty level, such as senior citizens. If a municipality decides to adopt a low income discount, a number of rules apply. First, the discount rate selected will apply to all users who qualify for the discount. Second, eligibility for the discount must be verified on an annual basis. Finally, all revenues that are lost because of the discount must be recovered from other system users through increased service charges. A notice that informs the public about the low income discount must also be published in a newspaper of general circulation within the municipality's service area. Under the

Guidelines, any pre-existing agreements which levy OM&R charges that are different than the proportional use rates calculated by the revenue program will not be allowed to continue, and the charges must be revised to reflect the approved rates. The user charge system shall take precedence over any terms or conditions contained in agreements or contracts that the municipality may be a party to that are inconsistent with the requirements of the SWRCB Guidelines. If there are any pre-existing contracts or agreements that are inconsistent with the Guidelines, the municipality must notify the SWRCB at the time the revenue program is submitted for review.

In the Guidelines, the SWRCB recommends that funds for the cost of debt service, capital improvements, etc. be collected with the OM&R user charge in proportion to the cost of the service rendered. A municipality may meet these revenue requirements through service charges, ad valorem taxes, standby charges, or assessments. If debt service and capital improvement costs are collected through service charges, and the municipality does not wish to recover these costs in proportion to system use, then a public notice describing the impacts of the proposed rate structure is required. An opportunity for public comment prior to final adoption of the rate ordinance must be given. Notice of the proposed rate shall be given by direct mailing to all organizations and individuals who have previously requested such notice, as well as to all system users who would be adversely affected by the change in rates.

Allocation of OM&R costs based on flow only can be made if the system serves less than 10,000 people, has no industrial users, and does not receive septage. A flow only OM&R cost allocation can also be used where the residential design flow for the treatment works exceeds 95 percent of the total design flow and there are no industrial or septage flows.

A municipality's user charge system based on ad valorem (A/V) taxes may be approved if the municipality had a system of dedicated A/V taxes in existence on December 27, 1977 and has continued to use that system to collect revenues to pay OM&R costs for wastewater treatment works within its service area. The A/V user charge system must distribute OM&R costs for all treatment works within the municipality's service area to the residential and small non-residential user classes including, at the municipality's option, other users that are not required to have their costs allocated individually. Each industrial and commercial user that discharges more than 25,000 gpd or more than 5 percent of the plant's design flow must pay its share of OM&R costs for the treatment works based on charges for actual use. Finally, a system of surcharges and rebates must be instituted to ensure that all users and user groups pay their proportionate share of the OM&R costs.

OM&R costs for all infiltration and inflow (I/I) that is not directly attributable to users must be distributed among all users in the same manner that it distributes the costs for their actual use. Alternatively, I/I costs can be distributed under a system that uses one or any combination of the following factors on a reasonable basis: flow volume of the users, land area of the users, number of hookups or discharges of the users, and property valuation of the users (if A/V taxes are used).

The Guidelines state that administrative costs for the wastewater system may be included in the OM&R cost allocation, or they may be separated and allocated on another equitable basis such as the number of sewer accounts.

## E. Other Considerations

The California Administrative Code prescribes a uniform system of accounts for wastewater disposal systems. Municipalities that are not subject to the uniform system of accounts must establish accounting systems for wastewater conveyance, treatment, and disposal that will provide essentially the same level of detail as the uniform system. Wastewater activities shall be accounted for in an enterprise fund which will consist of at least two revenue and three expense accounts. Revenue accounts include a service charge revenue account and a capital revenue account. Funds from the service charge revenue account can be used for any wastewater-related activity. However, funds from the capital revenue account may only be used for facility expansion, upgrade, or major rehabilitation. OM&R costs may not be funded from the capital revenue account. Expense accounts include an operation and maintenance account, a replacement account, and a capital expenditures account. The first two accounts must be funded from the service charge revenue account. Either revenue account can be used to fund the capital expenditures account. The replacement account should not include money set aside for unexpected price increases. Funds for this purpose should be accumulated in an operating reserve fund. The City's system of accounts, while different from the uniform system of accounts described by the California Administrative Code, provides essentially the same level of detail as the uniform system.

Connection fees can be used to recover debt service costs which would have been recovered on an annual basis if the user had been connected when the treatment works began operation. This fee may not be used to recover excessive costs from future users of treatment works in order to reduce charges to current users. Connection fees may not be used to fund replacement costs (as defined by the SWRCB).

If a municipality charges a flat rate for some users and a variable rate based on water consumption for others, a minimum charge may be established for the variable rate users to collect the fixed costs of providing service. This charge must not be more than the minimum charged to any user group which is charged a flat rate. The same minimum charge must be applied to all user groups which have a minimum charge, unless it can be shown that fixed costs vary significantly.

When treatment works serve more than one municipality, the user charge system outlined in the revenue program must cover all wastewater treatment services provided, and each participating municipality must adopt its own user charge system and rate ordinance or resolution. If the regional municipality is authorized to bill all of the individual users of the system, only one revenue program and rate ordinance is required. If the regional municipality bills a subscribing municipality, which in turn bills the individual users, separate revenue programs and rate ordinances are required for the regional municipality and each subscribing municipality. The regional municipality's charges to a subscribing municipality must be based on actual usage and include the fixed cost of reserved capacity, if capacity is reserved for specific subscribing municipalities.

In 1973, the SWRCB adopted guidelines for administering the "Fair and Equitable" clause contained in Clean Water Grant contracts. The intent of this clause is to protect municipalities that are required to join regional systems, as a result of State Board planning decisions, from undue financial burdens or inequitable treatment by the regional agencies. The guidelines focus on two areas of concern: the costs assessed to participating agencies, and the appropriateness of conditions imposed by the regional agency. In determining reasonable costs and charges to a participating agency, consideration should be given to the amount of flow, the strength of waste, and any special waste characteristics. Costs for treatment, including both OM&R costs and capital costs, must be apportioned among the users in direct proportion to the actual or allocated use. Costs of conveyance may be assigned directly to a participating agency in direct proportion to use if it is geographically separate or has other distinct and discrete characteristics. Otherwise, all conveyance costs shall be considered a basic part of the regional facilities, shall be combined with treatment costs, and will be apportioned in the same manner as are treatment costs. Costs that exceed the actual costs incurred by the regional agency and which, in effect, penalize participating agencies are improper and are not considered fair and equitable.

# IV. METROPOLITAN WASTEWATER SYSTEM ORGANIZATION AND OPERATION

## A. The Wastewater System

The Wastewater System that is the subject of this cost-of-service study consists of the Municipal (Muni) System, which is a municipal sewage collection system for the City's residents, and the Metropolitan (Metro) System, which is a regional sewage collection, treatment and disposal system initiated in 1958 (and operational since 1963) to serve the City and various other public agencies including cities situated within common drainage areas. The Metro System was designed to provide sufficient capacity to accommodate a regional population of 2,600,000. The City, as owner and operator of the Metro System, is the holder of the National Pollutant Discharge Elimination System (NPDES) permit and is responsible for maintaining the discharge requirements required under Federal law. The Metro System, as presently designed, provides advanced primary treatment of sewage at its Point Loma Wastewater Treatment Plant.

The map included as Exhibit IV-1 shows the sewer service area boundaries of the wastewater system which covers approximately 450 square miles, including most of the City.

1. **Muni System Facilities.** The Muni System is comprised of 2,528 miles of trunk and collector mains, 82 sewer pump stations and 14 stormwater interceptor pump stations serving in excess of 240,000 customer accounts. On average, these accounts generate 128 million gallons per day (mgd) of wastewater which is conveyed by the Muni system to the Metro system for treatment and disposal. The Wastewater System Capital Improvement Program (CIP) contemplates expenditures of $360.1 million for Muni system facilities during the seven Fiscal Years ending June 30, 2003.

2. **Metro System Facilities.** The current Metro System infrastructure, with the exception of the South Metro interceptor, is located within the jurisdictional boundaries of the City and is concentrated along a kidney shaped corridor running from Mission Bay to the north and along the perimeter of the San Diego Bay to the south. The map included as Exhibit IV-1 shows the geographic concentration of the Metro System's infrastructure and identifies the major interceptor lines north and south which service the Participating Agencies.

The Metro System's infrastructure consists of one main wastewater treatment plant, an ocean outfall, a sludge drying facility, two pump stations, and force mains and gravity flow interceptors. A brief description of the current facilities and their primary functions is provided below.

a. **Point Loma Wastewater Treatment Plant.** The wastewater treatment process currently employed at the Point Loma Plant consists of advanced primary treatment currently rated at 240 mgd of average daily wastewater flow and includes mechanical screening, by which raw wastewater flows into the Point Loma Plant through five 15 millimeter mesh mechanically self-cleaning traveling screens, the addition of chemical coagulants to enhance settling to achieve at least 80 percent removal of suspended solids, sedimentation, and sludge digestion. A digester gas utilization facility is also a part of the Point Loma Plant. Dewatering and disposal and/or reuse of sludge are provided off site.

Several capital improvement projects have been completed at the Point Loma Plant to rehabilitate, modify, and expand various components, and additional capital improvements are planned. Ongoing capital improvements include construction of two new sedimentation basins for a total of twelve basins, completion of a new effluent channel to all of the sedimentation basins, repair and modernization of two of the six digesters, construction of a new sludge pumping station, a new water tank, two additional digesters, automation of process control facilities, and restoration of the ocean outfall intake structure. Projects under design include upgrade of the headworks, odor control and grit removal facilities, modernization of two existing digesters, a new operations building, expansion of the gas utilization facility, a central boiler facility, and expansion of the maintenance building.

b. **Point Loma Plant Ocean Outfall.** The Point Loma Plant Ocean Outfall was constructed in 1963 to provide a method for disposal of all plant effluent. The original capacity of the 11,316-foot long, 108-inch diameter outfall has been estimated at 390 mgd under the original design configuration. The City commenced construction in 1992 of a 12,500-foot extension of the original outfall. The Point Loma Plant Ocean Outfall Extension was completed in November 1993 resulting in a 4.5 mile long outfall discharging treated sewage effluent at a depth of 320 feet of water. It is one of the longest, deepest ocean outfalls in the United States. The capacity of the ocean outfall in its current configuration is estimated to be at least 432 mgd.

c. **Fiesta Island Sludge Drying Facilities; Metro Biosolids Center.** A portion of Fiesta Island, located in Mission Bay, is currently used by the City for mechanical dewatering and air drying of sewage sludge. Since 1963, digested liquid sludge at three percent solids has been pumped from the Point Loma Plant through an eight mile pipeline to Fiesta Island. At the facility, mechanical belt filter presses provide initial dewatering functions. Solar energy dries the sludge cake in open sand drying beds. When the sludge solids content reaches 50 percent, the dried sludge is transported off-site for either beneficial use or landfill disposal. The California Coastal Commission has directed that the City vacate its sludge drying facilities at Fiesta Island since the use of the island for sludge processing has been determined to be incompatible with its intended recreational use and the commission is imposing mitigation charges on the City until the facilities are vacated. The charges were $2 million per year for 1993 and 1994. The commission reduced the charge to $1.5 million per year as a result of the progress that has been made constructing the replacement facilities described below. These charges have been paid from Wastewater System Revenues to the City's Department of Parks and Recreation. The City plans to cease its sludge operations at the Fiesta Island facility in February 1998.

The City will complete the construction of replacement facilities in 1997 of the Metro Biosolids Center on a site at Miramar Marine Corps Air Station. The overall capital budget for the replacement facilities to be located at the Miramar site is expected to be approximately $238 million.

The Metro Biosolids Center will perform the following two primary functions. It will digest biosolids generated at the North City Water Reclamation Plant, and it will mechanically dewater biosolids from the North City Plant and the Point Loma Wastewater Treatment Plant. The Metro Biosolids Center will replace dewatering operations currently located on Fiesta Island which service the Point Loma Plant. A for-profit enterprise is operating a cogeneration facility at the site. A sludge drying facility is also proposed to be located at the Metro Biosolids Center. The sludge drying facility may be undertaken by a for-profit enterprise to produce agricultural fertilizer pellets. Other beneficial use options such as composting and direct land application are being considered along with landfill disposal.

**d. Pump Stations.** The two Metro pump stations began operation in 1963. The pumping facilities are reported to be in good condition, and all structures, including wet wells, are expected to last at least another 25 years. No major modifications or improvements are anticipated except for installation of additional new pumps and motors and the overhaul of existing pumps and motors as needed.

**e. Metro Interceptors.** The Metro System interceptors consist of two major branches, the South and North, which meet at Pump Station No. 2. Interceptor capacities are normally adequate for current peak flow, but in the near future some interceptor sections may be subject to peak flows that exceed design capacities. Under the Wastewater System Capital Improvement Program, it is contemplated that expenditures of $35.7 million remain to be made for interceptors during the period ending June 30, 2003. Construction projects are currently underway to address these future capacity needs.

**3. Additional Contractual Capacity Through the Escondido Wastewater Treatment Plant.** In addition to the Metro System facilities described above, in 1972 the City entered into a sewage disposal agreement with the City of Escondido, whereby up to five mgd of sewage from the Rancho Bernardo sewer service area of the City of San Diego may be treated at Escondido's Hale Avenue Treatment Plant. The term of the agreement is 50 years and may be extended for an unlimited number of ten- year periods at the City's option. The Escondido Wastewater Treatment Plant is not owned by the City of San Diego and is not part of the Metro System.

## B. General Operating Principles and Practices

The MWWD manages the Metro system and the Muni system. The wastewater system is operated with funds derived primarily from sewer service charges. All system revenues are deposited in the Sewer Revenue Fund, which is used to finance operation, maintenance, replacement, and capital improvements in both the Metro and Muni systems. As an enterprise fund, the Sewer Revenue Fund is held separate and apart from other funds of the City.

Wastewater generated by the Participating Agencies is metered as it enters the Metro system and charges for treatment are based on the measured flow, SS, and COD. Within the City, wastewater flows from individual locations are not measured, and metered water consumption is used to approximate each customer's sewage flow.

### C. Customer Information and Classifications

The Metro system serves the City of San Diego and fourteen Participating Agencies located outside the City. Within the City, sewer customers are grouped into the following four major classifications:

| Description | Rate Codes | Total Customers (Connections) |
|---|---|---|
| Single family dwelling | 11 to 15 | 198,979 |
| Other domestic (multiple living units) | 21 to 25 | 29,340 |
| Commercial | 31 to 35 | 19,146 |
| Industrial | 41 to 45 | 596 |

Exhibit IV-2 provides descriptions for all of the rate codes currently used by the City for billing purposes.. Customers with rate codes ending in "4" or "5" do not return any flow to the sewer system. Rate codes ending with "4" designate customers that are served by septic tanks or other on-lot sewage disposal systems. Rate codes ending with a "5" identify customer locations that have separate irrigation meters. Rate codes 51 through 97 designate customers located outside the City, fire sprinkler service, backflow meter locations, and temporary water meters for construction projects. Customers with these rate codes also do not return any flow to the sewer system.

### D. Current Sewer-Rate Structure

Participating Agencies located outside the City are currently billed for sewage conveyance, treatment, and disposal services . Customers within the City of San Diego are billed based on both the volume and suspended solids (SS) content of the wastewater generated. However, no charge is currently made for the organic content of the wastewater.

Sewer bills for single family dwellings in the Muni service area are based on winter month water usage and a SS concentration of 277 milligrams per liter (mg/L). Previous analyses have determined that winter month water consumption (December through March) in single family dwellings approximates the water used inside the dwelling unit on an average annual basis. Wastewater returned to the sewer system from single family residences is estimated to be 90 percent of winter month water use. Sewer bills for multiple living units are calculated using actual metered water usage and a 277 mg/L concentration for SS. The total calculated sewer bill is then reduced by five percent to reflect a 95 percent return to sewer for this user class. Water and sewer rates for the City of San Diego, as of January 1, 1997, are summarized in Exhibit IV-3. This rate schedule includes a six percent increase in sewer rates which became effective on October 1, 1996. An additional six percent increase in sewer rates became effective on July 1, 1997.

Sewer bills for non-residential customers are calculated using a separate rate schedule. A Sewer Classification Program was implemented in 1988 to determine the amount and strength of sewage discharges from commercial and industrial customers within the City. Amount refers to the percent of metered water that is discharged into the sewer system while strength refers to the SS (suspended solids) concentration of the wastewater. Similar customers were placed into categories and were assigned characteristic SS concentrations based on the type of business activity. The first ten SS classes range from 0 to 1,000 mg/L, in 100 mg/L increments. An eleventh class also exists for dischargers with SS concentrations in excess of 1,000 mg/L.

In addition to the classifications for SS, field inspections were conducted at various customer locations to determine what type of establishment a water meter is serving and how the water is used. This included gathering data on irrigation usage, cooling tower evaporation, water used in the product produced, and other similar information. This information was used in conjunction with the water consumption history of the customers to calculate the percent of total water use that is returned to the sewer system. There are a total of 20 return-to-sewer components in the current rate schedule for commercial and industrial accounts. The first 19 classes range from 5 to 99 percent return to sewer, in four percent increments. The twentieth class is for customers whose return to sewer is equal to the metered water use.

The current sewer rate schedule for commercial and industrial accounts is shown in Exhibit IV-4. Sewer Quality Codes (SQC) were developed to express both the SS concentration and percent return to sewer for non-residential customers. Classes A through K and L through V refer to the SS classes for commercial and industrial customers, respectively, while the 01 through 20 designation describes the percent return to sewer. For example, a SQC of A02 identifies a commercial customer that returns between 90 and 94 percent of metered water use to the sewer at a SS concentration between 0 and 100 mg/L. A SQC of L02 identifies an industrial customer with the same discharge characteristics. Bills for customers with a SS concentration in excess of 1,000 mg/L are computed based on 100 percent return to the sewer.

E. Description of the Capital Improvement Program

The Wastewater System Capital Improvement Program (CIP) consists of projects to upgrade both the Metro and Muni systems. Metro CIP projects include the following:

- Metro Biosolids Processing Projects
- North City Water Reclamation Plant
- Point Loma Plant Upgrade
- Point Loma Outfall Upgrade
- South Bay Water Reclamation Plant
- South Bay Sewer Conveyance System
- South Bay Ocean Outfall
- North and South Metro Interceptor Sewer Upgrades
- Other Metro System Projects

Muni System CIP projects generally include replacement of deteriorated sewer lines, rehabilitation of existing sewage pumping stations, and construction of new interceptor lines and pump stations.

The Wastewater System CIP will be funded by a combination of system revenues and debt financing. The projected source of funds for the capital improvement projects for Fiscal Years ending June 30, 1997, to June 30, 2003, include:

New Bond Issues
Grant Receipts
Contributions in Aid
Pay-As-You-Go Moneys
State Revolving Fund Loans[1]

As part of this cost-of-service study, six estimates of CIP cost projections were reviewed to evaluate the reasonableness of the cost projections and the soundness of the estimating methodology. The projects were chosen randomly and included both Metro and Muni System projects. Overall, the total estimated project costs appear to be conservative. The cost estimates were prepared by engineering firms based on industry standards and are adequate for projecting future capital improvement costs.

F. Agreements With Participating Agencies

The Metro system provides "wholesale" treatment services, including some sewage transport, treatment and disposal operations, to other cities and districts. The following entities, referred to as the "Original Participating Agencies" entered into sewage disposal agreements with the City of San Diego in 1960:

City of Chula Vista
City of Coronado
City of El Cajon
City of Imperial Beach
City of La Mesa
City of National City
Lemon Grove Sanitation District
Spring Valley Sanitation District

Subsequent to that time, the City entered into sewage disposal agreements with the following entities, also known as the "Later Participating Agencies:

City of Del Mar
City of Poway
Lakeside/Alpine Sanitation District
Otay Water District
Padre Dam Municipal Water District
Wintergardens Sewer Sanitation District

Sewage disposal agreements expire on August 21, 2003, for the Original Participating Agencies and on June 30, 2003, for the Later Participating Agencies and, in each case, have a ten year extension option to 2013.

[1] *Presently, the City's Financing Plan takes a conservative approach and does not anticipate revenue from State Revolving Loan Fund.*

Each participating agency pays its proportionate share of the OM&R expenses of the Metro System. Under the agreements, the OM&R costs include all required repairs, reconstruction, and replacements to the Metro System. As of October 29, 1996, the City and the Participating Agencies agreed on the "Principles of Understanding" (see Exhibit IV-5). This document was established as a basis for agreement regarding the sharing of certain sewer costs.

One important provision of the "Principles of Understanding," Principle 2, states that the Participating Agencies are responsible for paying their fair share based on their proportionate flow within the Metro System, for the entire Metro System including but not limited to the Point Loma and North City facilities, up to their current contract capacity, which includes 234 mgd (now reestablished as 240 mgd), plus all facilities required by the Ocean Pollution Reduction Act of 1994 (OPRA).

Another provision, Principle 6, establishes the Metro System share of the costs for four specific capital improvement projects. The percentages to be paid by the Participating Agencies for these four projects are:

29% of Pump Station No. 2, Pumps 7-8
55% of the North Metro Interceptor
66% of Sedimentation Basins Nos. 9 and 10
24% of Sedimentation Basins Nos. 11 and 12

However, certain Later Participating Agencies (the City of Poway, the Lakeside/Alpine Sanitation District, the Padre Dam Municipal Water District, and the Wintergardens Sewer Maintenance District) will continue to pay the costs of both sedimentation basin projects based on 100 percent.

Another important provision of the "Principles of Understanding" is found in Principle No. 10, which states that the Metro System, including the Participating Agencies, shall not pay for City of San Diego right-of-way charges. The current Fiscal Year 1997 budget and future budget projections through Fiscal Year 2003 do not allocate right-of-way charges to any of the Participating Agencies.

Through Fiscal Year 1997, OM&R costs were recovered from the Participating Agencies on a flow-only basis without consideration of strength of discharge. The Participating Agencies were billed quarterly by MWWD on the basis of budgeted cost estimates and sewage flow estimates. In the following fiscal year, when actual costs and actual flow data were known, billing adjustments were made to correct for any under or over charges in the previous year. Starting in Fiscal Year 1998, strength based billing was implemented based on budgeted cost estimates and cash flow analyses and on estimated flow, SS, and COD. The same process of adjusting to actuals will take place for Fiscal Year 1998. This will include actual costs, flow, strength and oxygen demand based on cumulative sampling for strength and COD.

The Participating Agencies are responsible for the "retail" sewage collection operations within their respective jurisdictions. The collection systems and many of the transport trunk lines are owned by the individual Participating Agencies. There are also transportation agreements between agencies as flows enter and leave other agencies' boundaries.

## VII. ALLOCATION OF EXPENSES TO CUSTOMER CLASSES

For purposes of this discussion, the customer classes are Participating Agencies, the City of San Diego, and Trucked Wastes.

### A. Review of Flow and Load Allocation Information

The MWWD Technical Services Division provides City Financing Services personnel with periodic updates on Metro System wastewater flows and loadings. A memorandum dated October 7, 1996 discussed wastewater flow and load projections for the 1997 Financial Plan. That memo is included as Exhibit VII-1. The flow, COD, and SS projections in the memorandum were developed based on historic loadings at the Point Loma Plant and estimated rates of population growth for the City of San Diego and the Participating Agencies. The figures presented in the October 1996 memo were used in this cost-of-service study as the total projected loadings on the Metro System. The average percentage of flow contributed by the City and each of the Participating Agencies from 1994 to 1996 was applied to the projected total Metro System flow for 1997 through 2003 to estimate the flow contribution of each.

Chemical oxygen demand (COD) was used by the MWWD for sampling rather than biochemical oxygen demand (BOD). COD testing was selected over BOD testing because of overall ease of sampling, less potential for procedural error, more timely results, and significantly lower laboratory costs. The Participating Agencies agreed to COD sampling.

COD and SS concentrations were measured at various sampling points within the City and at Participating Agency connection points for the purpose of establishing a strength based billing system. Exhibit VII-2 shows the baseline data measured between June 1995 and December 1996, along with the sampling points at which the measurements were made. Flow-weighted average COD and SS concentrations were calculated for the City and each Participating Agency. Organic and solids loadings on the system were then estimated using the flow projections in conjunction with the average concentrations. Organic and solid loadings of the system are tested daily. Cumulative data was analyzed and estimates for system flow, SS, and COD were provided for Fiscal Year 1998 Strength Based Billing.

For the implementation of Fiscal Year 1998 strength based billing, solid and organic loadings were estimated based on at least six individual samples for each agency, including the City of San Diego. System flow, suspended solids, and COD were also estimated based on plant data collections. Exhibit VII-2 (Table 1) (without system loadings) shows the Flow, SS, and COD sampling average for each agency, for the City of San Diego, and for the system as a whole.

In addition to the flow, solids, and organic loadings contributed by the Participating Agencies, the City of San Diego, and the City of Tijuana via the emergency connection, the Metro System processes trucked wastes. In 1996, over 34 million gallons of trucked domestic and industrial wastes were received from permitted haulers. An additional 1.40 million gallons of domestic only waste was received from permitted haulers by the El Cajon Department of Public Works. Three haulers were also permitted to discharge 1.60 million gallons of grease trap water after separation of grease solids and oil. A domestic trucked waste characterization study conducted in January 1996 measured average COD and SS concentrations of 19,226 mg/L and 13,780 mg/L, respectively, for more than 60 samples of portable toilet, septic tank, and holding tank wastes. Likewise, return flows from the Fiesta Island sludge dewatering facility add to system loadings. The average decant from Fiesta Island in 1996 was 1.679 mgd and contained 597 mg/L of COD and 1,231 mg/L of SS. Information on trucked waste and Fiesta Island loadings is contained in Appendix VII-1 and, respectively, Exhibit VII-3.

Return flows from Fiesta Island are shared by all system users based on the proportion of flow, COD, and SS that each contributes. Infiltration and inflow (I/I) to the Metro System is component that should be shared proportionately by all users. Wastewater flows from areas outside the City are metered as they enter the Metro System. As a result, the Participating Agencies pay for all of the I/I that occurs in their individual systems. However, adequate data is not currently available to allocate Metro I/I to all system users. MWWD is planning to conduct additional flow monitoring so that I/I can be allocated between the City and the Participating Agencies.

### B. Distribution of System Loadings to City and Participating Agencies

Tables VII-1, VII-2 and VII-3 present projected annual flow, COD, and SS contributions, respectively, for the Metro System. As discussed above, return flows from Fiesta Island have been allocated to all the system users based on the proportion of flow, COD, and SS that each contributes.

Including its share of Fiesta Island loadings, the City contributes an estimated 70.19 percent of the flow, 73.74 percent of the COD, and 74.89 percent of the SS to the Metro System. The Participating Agencies contribute approximately 29.75 percent of the flow, 24.74 percent of the COD, and 22.49 percent of the SS. System flow was estimated to be 68,225 million gallons, which included 638.74 million gallons of return flow. COD was estimated to be 411,125 thousand pounds, including 3,051 thousand pounds regional return. Trucked wastes only account for 0.06 percent of the flow but contribute an estimated 1.52 percent of the COD and 2.62 percent of the SS.

### C. Distribution of System Loadings to Customer Classes Within The City

Metered water use and sewer billing records were analyzed to estimate system loadings from sewer customers within the City. Annual water usage in hundred cubic feet (HCF) was provided by the Water Utilities Department for the single family and other domestic customer classes. Similar information was also provided for individual commercial, industrial, and other sewer accounts that have been assigned a sewer quality code (SQC). The SQC designates the SS contributed by a customer and the percentage of the metered water that is returned to the sewer system.

Table VII-4 lists historic water usage for single family and other domestic accounts. These two customer classes used 53,572,742 HCF during the 12 month period ending March 31, 1997. However, the estimated return to the sewer is less than the metered water use and, therefore, sewer bills for single family dwellings are based on 90% of the winter months water use (December through March). The average winter months water use for single family dwellings translates to a 67.78 percent return to sewer relative to the total metered HCF for the entire year. Literature on this subject indicates that between 60 and 80 percent of the water consumed typically becomes wastewater, with the lower percentages applicable to semi-arid regions of the Southwestern United States. The calculated return to sewer for single family dwellings (67.78%) is within the typical range (60% to 80%). Sewer bills for multiple living units are calculated using actual metered water usage, but receive a 5.0 percent reduction to reflect an estimated 95 percent return to sewer for this user class.

The City's share of Metro System loadings was allocated to City sewer customers by adjusting total metered water use to reflect the percent return to sewer and calculating SS and COD loadings based on assigned concentrations for each rate code or sewer quality code. SS concentrations of 277 mg/L were used to determine loadings for single family and other domestic customers. All sewer customers with Sewer Quality Codes have been assigned representative SS concentrations by the Water Utilities Department Sewer Classification Program based on the Standard Industrial Classification (SIC) of the sewer customer. The SIC Guidelines list used by the Sewer Classification Program is included as Exhibit VII-6.

Commercial and industrial accounts were sorted by SIC code and SQC and were assigned the SS concentrations listed in Exhibit VII-4. However, some of the original classification assignments have been changed through an appeal process which allows reassignment to another SQC if sampling data shows that the actual SS is not consistent with the assigned SQC. Where the SS for the SIC code did not agree with the SS for the SQC, the mid-point value for the SQC was assigned to the account.

COD values were assigned to City sewer customers based on typical COD concentrations provided by Los Angeles County Sanitation District No. 1 and BOD information contained in the SWRCB Guidelines.

Appendix VII-2 presents the City's contribution to flow, COD and SS based on metered water use for the period ending March 31, 1997. Calculations for the single family category were based on a 67.78 percent return to sewer and a 95 percent rate was used for the other domestic category. The mid-point return to sewer percentage was used for all customers with SQC assignments. Table VII-5 summarizes the results of this analysis. As shown by the comparison at the bottom of Table VII-5, the total City loadings produced by this analysis do not match the City's overall share of system loadings presented in Tables VII-1, VII-2 and VII-3. Therefore, the unit cost factors for flow, COD, and SS that are calculated for the Metro and Muni systems have to be adjusted by the multipliers shown when determining cost allocations for City customers.

As noted above, total loadings for the City based on the allocation to customer classes do not match the City's overall share of Metro system loadings. The City's flow contribution calculated by the allocation process is only about seven percent less than the City's share of Metro flows, but the COD and SS loads are more than 20 percent lower. It is reasonable to assume that part of the difference in flow can be attributed to I/I in the Muni and Metro systems. The amount of I/I in the system is not known, but it may constitute a considerable amount of the seven percent, in which case the assumed return to sewer values would produce flows comparable to actual and projected values. The infiltration component of I/I is typically low in both COD and SS, while the amount of COD and SS from inflow varies based on the source. Since inflow events are isolated and directly related to precipitation events, it is anticipated that inflow does not contribute much to the total COD and SS loads. The most likely explanation for the difference in COD and SS loadings is that the concentrations used in the allocation process do not accurately reflect actual conditions. Rather than adjusting concentrations for individual customers or customer classes to increase the total loadings, a unit cost multiplier was used to increase the cost allocation to each class by a proportional amount.

## D. Unit Costs for Flow, COD, and SS

Table VII-6 calculates unit costs for flow, COD, and SS for the Metro and Muni systems for the years 1997 through 2003, inclusive, and the average for the seven year period. More than 90 percent of Muni System costs are related to flow while Metro System costs are more evenly distributed between flow, COD, and SS. The calculated unit costs vary from year to year based on projected expenditures but generally exhibit an upward trend. Unit costs are higher for the City than for the Participating Agencies because the City has to fund its share of Metro System costs plus all of the costs related to the Muni System. Each of the Participating Agencies will have to calculate the costs related to their individual sewage collection and conveyance systems.

## E. Total Annual Cost Allocations for Flow, COD, and SS

Projected annual cost allocations for the Participating Agencies, the City, and trucked waste haulers are shown in Table VII-7. The separate cost allocations for flow, COD, and SS which are combined in Table VII-7 are presented in Tables VII-7a, 7b, and 7c.

Table VII-7 allocates system costs to the City, Participating Agencies, and trucked waste haulers. Total costs for the City include both Muni and Metro system costs. As shown in Tables VII-1, 2, and 3, the City accounts for about 70 percent of flow and about 74 percent of COD and SS. Overall, the City is responsible for about 82 percent of system costs which includes both the Muni and Metro systems, the Participating Agencies account for approximately 17 percent, and trucked wastes make up the balance.

# EXHIBIT 3

CITY OF SAN DIEGO
MEMORANDUM
CITY MANAGER'S OFFICE

DATE: June 28, 1996

TO: Honorable Mayor and City Council

FROM: Jack McGrory, City Manager

RE: Retirement Summary

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Attached is a summary of the Retirement proposal that you requested last week.

Jack McGrory

Attachments:
- June 28 Retirement Summary
- June 21 Modifications Proposal
- June 7 Retirement Proposal
- CERS Fiduciary Counsel Opinion

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June 28, 1996

# San Diego City Employee Retirement System (SDCERS)
## *PROPOSAL*

1. <u>RETIREE HEALTH INSURANCE</u>
a. Task Force of City Manager/Labor Organizations/CERS/Consultants to recommend Retiree Health benefit by 11/1/96 for City Council Approval by 1/1/97
b. Transfer obligation for retiree's health insurance from City to SDCERS
c. Fund retiree's health insurance from Undistributed Surplus Earnings, Annually
d. SDCERS to establish Health Insurance Reserve from Earnings

2. <u>BENEFIT CHANGES</u>
a. Eliminate Disability Income Offset
b. Provide Health Insurance for those retiring before 10/6/80
c. Double 13th Check for Pre-1980 Retirees:
   -from $30/year of service to $60/year for those retiring before 10/6/80
   -from $30/year of service to $75/year for those retiring before 12/31/71
d. Provide for the Purchase of up to 5 years of Service Credit (employee would pay the total cost for purchase of service credit)
e. Improve Formula for General Members, Police, Fire, and Lifeguard Members
f. City agrees to develop a Deferred Retirement Option Plan (DROP) by 4/1/97 with no cost impact to SDCERS or the City.

3. <u>RATE STABILIZATION</u>
a. CERS will annually adopt employer rates based on actuary's valuation
b. CERS, upon advice of its fiduciary counsel, has agreed to funding employer rates from a combination of the "agreed to" rates in the Proposal paid by the City annually, with the difference paid from a transfer of accumulated excess undistributed earnings on investments. (Approx. $135 million excess earnings were set aside by CERS action 6/21/96 for this purpose subject to final approval of the entire *Proposal)*
c. The "agreed to" rate paid by the City will increase by .50% annually until such time it reaches the actuarially determined rate.
d. At such time as the PUC rate meets the EAN rate, it is the intent to convert to EAN.

5. <u>PROCESS</u>

| | | |
|---|---|---|
| a. | Meet and Confer with Labor Organizations | (Completed 6/5/96) |
| b. | Review and Advice from Actuary and Fiduciary Counsel | (Completed 6/21/96) |
| c. | Approval by CERS Board (Retiree Health outstanding) | (Completed 6/21/96) |
| d. | City Council Approval | (Scheduled 7/2/96) |
| e. | Approval/Vote of CERS Members | (Scheduled 9/96) |
| f. | Task Force Recommendation on Retiree Health Insurance | (Due 11/1/96) |
| g. | Ballot measure on Charter amendment-Retiree Health | (11/5/96 election) |
| h. | City Council Approval of Retiree Health Insurance subject to approvals of legal counsel, fiduciary counsel tax counsel, etc.) | (Due 1/1/97) |
| i. | Implementation of Benefits Improvements subject to above | (1/1/97) |

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# EXHIBIT 4

*City of San Diego*
*MEMORANDUM*

Date: June 21, 1996

To: City Employees Retirement System Board of Administration

From: Jack McGrory, City Manager

Subject: *Modifications to Retirement System Proposal Dated June 7, 1996*

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As a result of issues raised by Dwight Hamilton, Fiduciary Counsel to the CERS Board of Administration, the Manager herewith makes the following modifications to the Proposal dated June 7, 1996, with the understanding that having made these changes, Mr. Hamilton will advise the CERS Board that approving the actions within their jurisdiction related to employer rates, surplus undistributed earnings and reserves may be approved.

Issue No. 1 - RETIREE HEALTH INSURANCE

Inasmuch as Mr. Hamilton is not prepared to advise the CERS Board at this time regarding the obligation of Retiree Health Insurance moving to CERS, and the methodology for paying the cost therefor from excess undistributed earnings, the following changes are made.

1. It is proposed that the obligation for Retiree Health Insurance be moved to CERS effective July 1, 1997, contingent upon advice from its fiduciary counsel that the specific terms of this action are deemed legal and appropriate prior to January 1, 1997. It is the City's intent and expectation in this Proposal that the cost of providing retiree health insurance will not be amortized but rather will be paid on an annual basis from excess undistributed earnings.

   It is the intent that the Task Force described in the June 7 Proposal complete its work and present a recommendation by November 1, 1996. Final approval of the specific Retiree Health Benefit that will be transferred to CERS will be subject to approval of the City Council.

2. Retiree Health Insurance for Pre-1980 Retirees will be provided by the City at the same rate as in FY96 for one additional year, FY97. Contingent upon the approval of item 1 above, Pre-1980 Retiree Health Insurance will become an ongoing benefit as described in the June 7, 1996 Proposal.

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Issue No. 2 - BENEFIT CHANGES

These benefit changes do not require any action by the CERS Board, but rather are presented as part of the overall proposal.

It is the Manager's intent to provide the increased benefit to the 13th check due in FY97, and that such increased benefit thereafter would only occur if the balance of the Proposal is approved by January 1, 1997.

The actual employee paid contribution rates described in Issue No. 2 of the June 7, 1996 Proposal are slightly modified to coincide with the rates identified in the CERS Board actuary's letter (Rick Roeder) dated June 13, 1996 to Mr. Larry Grissom.

Issue No. 3 - EMPLOYER CONTRIBUTION RATES

The CERS Board is charged with the responsibility of establishing employer contribution rates.

Paragraphs "B" and "C" are modified to read as follows:

B. The City will pay the agreed-to rates shown above for FY 96 through FY 2007. In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation which will include the impact of the benefit improvements included in this Proposal, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation.

C. If the System's actuary makes changes in actuarial assumptions or methodology which are approved by the Board prior to July 1, 2007, any changes in the employer contribution rate will adjust the PUC rate to be achieved through extended incremental increases shown in paragraph A above. If the phase-in would require an extension past July 1, 2009 in order to achieve the full actuarial PUC rate, the City-paid rate will be adjusted by the amount necessary to achieve full phase-in by that date.

Issue No. 4 - SURPLUS UNDISTRIBUTED EARNINGS AND RESERVES

The Proposal dated June 7, 1996 is modified to read as follows:

The System's actuary performs an annual actuarial valuation which shows the present value of accrued liabilities and the value of assets allocated to funding. To the extent that liabilities exceed assets, the System will show an unfunded liability. The System's liabilities will be impacted in the following ways, including those related to the City Manager's proposal for restructuring the System.

NORMAL LIABILITIES - This liability relates to the impact of actuarial gains or losses recognized when actuarial assumptions are compared to the System's actual experience. When experience is better than assumptions, the System shows actuarial gains and liabilities decrease. When experience is worse than assumptions, the System shows actuarial losses and liabilities increase. This will take place regardless of whether or not the restructuring proposal is approved.

NORMAL COST OF INCREASED BENEFITS - When benefits are increased, liability is created representing the prospective value of those benefits. Employee and employer contribution rates are increased for the purpose of paying that cost as it is accrued.

PAST SERVICE LIABILITY OF INCREASED BENEFITS - The proposed restructuring provides for an increase in the formula for calculating benefits. This means that, in the case of a general member, each year of accrued service that had a value of 1.45% of final average salary at age 55, increases in value to 2.00% of final average salary at age 55 upon the effective date of the increase. This increases the cost to the System to pay the benefit, which increases liabilities since no contributions have been received in the past to fund the benefit at this level. This is what is known as past service liability.

The actuary has estimated the amount of past service liability created by the restructuring proposal to be $76.7 million expressed in 1996 dollars.

CONTRIBUTION SHORTFALL LIABILITY - The restructuring proposal provides that the employer contribution rate will be "ramped up" to the actuarially recommended rate in increments over the next 10 years. This means that the System will be receiving less in contribution dollars over that period, which creates an additional liability.

The actuary has estimated the amount of contribution shortfall liability created by the restructuring proposal to be $30.0 million expressed in 1996 dollars.

A. The system has "surplus" undistributed earnings and a balance in the Earnings Stabilization Reserve as follows:

| | |
|---|---|
| FY ended 6-30-95 | $ 38,813,314 |
| FY ended 6-30-96 | 85,472,254 |
| Earnings Stabilization Reserve | 10,769,620 |
| Total | $135,055,188 |

The actuary has estimated increased liabilities associated with the restructuring proposal in the amount of $106,700,000 (see the discussion segment above). Credit the Employer Contribution Reserve in the amount of $106,700,000 for the purpose of discharging the restructuring liability. Credit the Employer Contribution Reserve with $28,356,188 (the remaining balance) for the purpose of reducing the System's normal unfunded liability.

TOTALITY OF THE PROPOSAL

If the necessary contingencies identified to approve this Proposal in its entirety are not affirmatively met by January 1, 1997, then:

A. Retiree Health Insurance will remain a City provided benefit, rather than CERS;

B. The CERS benefit improvements listed in Issue No. 2 would not occur;

C. The employer contribution rates to be paid would be those established by the System's Actuary.

In order to facilitate the accomplishment of this Proposal, it is recommended that the CERS Board direct that the $106,700,000 identified in Issue No. 4 as the amount necessary to discharge the restructuring liability be set aside in a reserve until January 1, 1997.

City Employees Retirement System
June 7, 1996

*Proposal*

It is the City Manager's intent to recommend changes to the City Employees Retirement System related to: (1) retiree health insurance, (2) retirement plan benefits, (3) employer contribution rates, and (4) retirement system reserves. These proposed changes to plan benefits, retiree health insurance, employer rates and system reserves will require approval of the City Council, CERS Board of Administration as well as an affirmative vote of plan members. The City Manager's proposal is being reviewed by outside fiduciary counsel engaged through the City Attorney's Office and has been presented to the CERS Board's fiduciary counsel and actuary for review and advice to the Board. All proposed changes are conditioned upon and subject to final approval by fiduciary counsel, City Council approval, Retirement Board approval, vote of plan participants, and confirmation of cost estimates by the System's actuary.

The interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently. Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decisions. Necessary ordinances can be prepared for formal amendments to the Municipal Code subsequent to actions by appropriate bodies (City Council, CERS Board, Plan Participants, Employee Unions). Following are the proposed changes.

Issue No. 1 - RETIREE HEALTH INSURANCE

A. Move the Retiree Health Insurance from the City to CERS effective July 1, 1997.

B. Increase premium reimbursement for POA and Local 145 Retiree Health Plans from $4500/year to $4995 only for FY97.

C. Establish Pre-1980 Retiree Health Insurance as a permanent benefit at a level of $600 per year.

D. During FY97, a Task Force of City Manager, CERS Board and Labor Organizations working with actuaries, consultants and legal counsel can develop the necessary documentation to design a tax exempt health insurance benefit to be effective July 1, 1997. The Task Force will recommend benefit level subject to approval by CERS, City Council, and issue an RFP for selection of a common provider. POA and Local 145 will assume full responsibility for any incurred claims under existing health insurance policies.

E. The existing City Health Insurance Trust (@ $12.5m) will be used to pay for FY97 Retiree Health Insurance.

F. CERS will establish a Health Insurance Reserve within CERS. Each year, the upcoming year's projected cost of retiree health insurance will be transferred from undistributed earnings and credited to the Health Insurance Reserve.

G. Actual premium costs and administrative charges will be charged to the Health Insurance Reserve on a pay-as-you-go basis and will not be actuarially funded.

Issue No. 2 - CERS BENEFIT CHANGES

A. Eliminate the existing requirement to offset Disability Income.

B. Purchase of Service Credit: Continue the existing service credit provisions related to refunds, probationary periods, 1981 Plan waiting period and Military & Veteran Code; incorporate all others into a new general provision of a five (5) year purchase of service credit feature, which would also be available to ½ time and 3/4 time employees. Employees would pay into the retirement fund an amount, including interest, equivalent to the employee and employer full cost of such service.

C. Increase the calculation of the 13th Check for Pre-10/6/80 retirees from $30 per creditable year of service to $60 per creditable year of service, and to $75 per creditable year of service for Pre-12/31/71 retirees. It is also the Manager's intent to conduct a study during the first quarter of FY98 on COLA alternatives including but not limited to a 75% purchasing power formula.

D. Increase the benefit to General Members for industrial disability retirements from 33-1/3% to 50%; and increase the General Member formula as described below.

General Member Formula

| Age | Present Factor | Proposed Factor |
|---|---|---|
| 55 | 1.48% | 2.00% |
| 56 | 1.56% | 2.00% |
| 57 | 1.63% | 2.00% |
| 58 | 1.72% | 2.00% |
| 59 | 1.81% | 2.08% |
| 60 | 1.92% | 2.16% |
| 61 | 1.99% | 2.24% |
| 62 | 2.09% | 2.31% |
| 63 | 2.20% | 2.39% |
| 64 | 2.31% | 2.47% |
| 65+ | 2.43% | 2.55% |

Cost of General Member Improvements:

| | Employer-Paid | Employee-Paid | Total Cost |
|---|---|---|---|
| Normal Cost | +1.11% | +1.10% | +2.21% |
| Past Liability | +1.43% | ______ | +1.43% |
| TOTAL COST | +2.54% | +1.10% | +3.64% |

Past liability for these two benefit improvements will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97. The employee's share will be paid from excess earnings for FY97, and by increasing the employee's contribution in FY98 and FY99 as follows: +.55% on 12/27/97 and +.55% effective the earliest date in FY99 that General Employees receive a salary increase.

E. Improve **Lifeguard Safety Member Formula** as follows and establish a 90% cap. Any employees who are eligible for a percentage above 90% on 4/1/97, the effective date of implementation of the DROP will be frozen at their rate in effect on 4/1/97. Past liability for this benefit improvement will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97. The employee's share will be paid from excess earnings in FY97, and by increasing the employee's contribution in FY98 and FY99 as follows: +.245% on 12/27/97 and +.245% effective the earliest date in FY99 that Lifeguard employees receive a salary increase.

| Age | Present Factor | Proposed Factor |
|---|---|---|
| 50 | 2.00% | 2.20% |
| 51 | 2.10% | 2.32% |
| 52 | 2.22% | 2.44% |
| 53 | 2.34% | 2.57% |
| 54 | 2.47% | 2.72% |
| 55+ | 2.62% | 2.77% |

Cost of Lifeguard Safety Member Improvements:

| | Employer-Paid | Employee-Paid | Total Cost |
|---|---|---|---|
| Normal Cost | +.49% | +.49% | +.98% |
| Past Liability | +.53 | ______ | +.53% |
| TOTAL COST | +1.02% | +.49% | +1.51% |

F. Improve Police and Fire Safety Member Formula as follows and establish a 90% cap. Any employees who are eligible for a percentage above 90% on the date the new formula becomes effective, will be allowed to remain under the current formula with no cap. Past liability for this benefit improvement will be paid for by the City through excess earnings. Normal cost (prospective costs) will be paid for equally by employee and employer. The employer's share will be added to the actuarial rate (PUC) calculations beginning mid-year FY97.

| Age | Fire Factor | Police Factor | Proposed Factor for Fire & Police |
|---|---|---|---|
| 50 | 2.20% | 2.50% | 2.50% |
| 51 | 2.32% | 2.54% | 2.60% |
| 52 | 2.44% | 2.58% | 2.70% |
| 53 | 2.57% | 2.62% | 2.80% |
| 54 | 2.72% | 2.66% | 2.90% |
| 55+ | 2.77% | 2.70% | 2.9999% |

Cost of Safety Member Improvements:

| FIRE | Employer-Paid | Employee-Paid | Total Cost |
|---|---|---|---|
| Normal Cost | +.73% | +.72% | +1.45% |
| Past Liability | +.91% | | +.91% |
| Total | +1.64% | +.72% | +2.36% |

Fire employees will pay one-half of the normal cost by an increase in the employee contribution of .72% effective 7/1/98.

| POLICE | Employer-Paid | Employee-Paid | Total Cost |
|---|---|---|---|
| Normal Cost | +.47% | +.47% | +.94% |
| Past Liability | +.91% | | +.91% |
| Total | +1.38% | +.47% | +1.85% |

Police employees will pay one-half of the normal cost by an increase in the employee contribution of .47% effective 7/1/98.

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G. The City agrees to implementation of a *Deferred Retirement Option Plan* (DROP) effective April 1, 1997, on the condition that such a plan is approved by the City Attorney's Office as legal under applicable Federal, State and Local laws and regulations, and that such a plan would not increase cost greater than the savings to the City nor CERS. Employees may participate in this program for up to five (5) years. At the end of three (3) years, the City will evaluate the cost impact of this program. If the cost impact to the City or CERS is greater than the savings, the City agrees to meet and confer to impasse prior to imposing any changes in the DROP Plan. If the City proposes to change the DROP Plan, the 90% cap on CERS would also be re-negotiated. Employees who elect to participate in DROP will cease participation in CERS, and will participate in an SPSP-type plan with a mandatory 3.05% employee contribution matched by 3.05% employer contribution.

Issue No. 3 - EMPLOYER CONTRIBUTION RATES

A. Employer rates will be calculated using the Projected Unit Credit (PUC) method. For FY96 and FY97, the City will pay the budgeted rates (bifurcated rate) of 7.08% (blended rate) and 7.33% respectively, and increase the rate paid by 0.50% each year until the rate paid reaches the EAN calculated rate. At such time as the PUC and Entry Age Normal (EAN) rates are equal, the System will convert to EAN.

Employer Contribution Rate Stabilization Plan

| Period | PUC Rate | City Paid Rate | Difference % | Difference $ |
|---|---|---|---|---|
| FY96 | 8.60% | 7.08% | 1.52% | $5.33m |
| FY97 | 10.87% | 7.33% | 3.79% | $13.88m |
| FY98 | 12.18% | 7.83% | 4.35% | $16.67m |
| FY99 | 12.18% | 8.33% | 3.85% | $15.40m |
| FY2000 | 12.18% | 8.83% | 3.35% | $14.00m |
| FY2001 | 12.18% | 9.33% | 2.85% | $12.45m |
| FY2002 | 12.18% | 9.83% | 2.35% | $10.72m |
| FY2003 | 12.18% | 10.33% | 1.85% | $8.82m |
| FY2004 | 12.18% | 10.83% | 1.35% | $6.73m |
| FY2005 | 12.18% | 11.33% | .85% | $4.43m |
| FY2006 | 12.18% | 11.83% | .35% | $1.91m |
| FY2007 | 12.18% | 12.18% | -0- | -0- |
| FY2008 | 13.00 | 13.00% | -0- | -0- |
| TOTAL | | | | $110.35* |

*$110.35 million paid from excess earnings includes $71.31 million in contributions as a result of benefits improvements recommended herein.

B. The City will pay the agreed to rates shown above for FY96 through FY2007. The difference between the actuarially calculated rate and the agreed to rate would be transferred from the Stabilization Reserve to the Employer's Contribution Reserve. If the amount in the Stabilization Reserve is insufficient to pay the difference in contributions or the funded ratio of the System falls by more than 10% below the funded ratio calculated at the June 30, 1996 valuation, this plan will sunset the year following the actuarial valuation which shows this funded ratio.

C. There will be no changes in actuarial assumptions or actuarial methodology which would impact employer contribution rates prior to July 1, 2007. If the CERS Board feels its fiduciary responsibility requires a change to actuarial assumptions prior to that date due to extraordinary circumstances, the increase in rate will be added to the PUC rate to be achieved through the phased-in rate increases.

Issue No. 4 - SURPLUS UNDISTRIBUTED EARNINGS AND RESERVES

A. Create a Contingency Reserve not to exceed 1% of System assets at market value. If undistributed earnings are insufficient, funds from the Contingency Reserve will be used, in priority order after crediting the employee and employer reserves and funding the Systems budget, to: (1) pay the insurance premium, (2) pay the 13th check. If the Health Insurance reserve and the contingency reserve were insufficient, the City would be responsible for that year's health insurance premium.

B. Create a Stabilization Reserve not to exceed $75 million, as follows: (1) close and transfer the existing "earnings stabilization reserve ($10.7 million), (2) credit this reserve annually with 50% of "surplus" undistributed earnings. All surplus undistributed earnings will be transferred to the employer contribution reserve when and if the $75 million limit is reached. These assets will be held outside of assets used for actuarial valuation.

FRANDZEL & SHARE
A LAW CORPORATION
6500 WILSHIRE BOULEVARD
SEVENTEENTH FLOOR
LOS ANGELES, CALIFORNIA 90048-4920
TELEPHONE (213) 852-1000
FAX (213) 651-2577

SAN FRANCISCO OFFICE
100 PINE STREET, 20TH FLOOR
SAN FRANCISCO, CALIFORNIA 94111-5212
TELEPHONE (415) 788-7400
FAX (415) 291-9153

OF COUNSEL
HAMILTON AND FAATZ
A PROFESSIONAL CORPORATION
DENVER COLORADO
NOT ADMITTED IN CALIFORNIA




SD RET OFF 1996 JUN 27 A. 7:51

OUR FILE #

June 21, 1996

Mr. Lawrence B. Grissom
Retirement Administrator
San Diego City Employees' Retirement System
Union Bank Building
525 "B" Street, Suite 1120
San Diego, CA 92101-4494

Dear Mr. Grissom:

You have requested on behalf of the Board of Administration our opinion on whether the Board would be discharging its fiduciary duties in acting upon certain recommended changes by the City Manager to the City Employees' Retirement System related to (1) Retiree Health Insurance; (2) Retirement Plan benefits; (3) Employer contribution rates; and (4) Retirement System reserves. Each of the recommended changes of the City Manager will be reviewed by summarizing each proposed change, ascertaining the action, if any, that is requested of the Board of Administration, and opining on the discretionary authority of the Board to administer the requested change.

1. Retiree Health Insurance. The City Manager seeks to empower CERS with authority to provide Retiree health insurance and to terminate the City-sponsored health insurance benefits. The City Employees' Retirement System was authorized by the San Diego City Charter, Article IX. Sec. 145, which provides that:

> All monies contributed by employees of the City or appropriated by the Council or received from any other source under the term of this Article shall be placed in a special fund in the City Treasury to be known as the City Employees' Retirement Fund, which said fund is hereby created. Such fund shall be a Trust Fund to be held and used only for the purpose of carrying out the provisions of this Article.

The Retirement System is not authorized to provide health insurance. It is our opinion that the San Diego City Charter would have to be amended to empower the City Employees' Retirement System to provide retiree health insurance. Until the Charter is amended, the City Manager's recommended change cannot be effected. Therefore no action is required by the Board of Administration at this time.

0638
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2. CERS Benefit Changes. The City Manager has proposed certain benefit changes:

a. Eliminating the existing requirement to offset disability income;

b. Incorporating a new general provision of a five-year purchase of service credit feature;

c. Increasing the calculation of the annual supplemental benefit (13th check) for pre-10/6/80 retirees from $30.00 per creditable year of service to $60.00 per creditable year of service, and to $75.00 per creditable year of service for pre-12/31/71 retirees;

d. Increasing the benefits to general members;

e. Improving life guard safety member formula;

f. Improving the police and fire safety member formula; and

g. Implementing a Deferred Retirement Option Plan.

To effect these changes, an ordinance amending the San Diego Municipal Code must be adopted by the City Council and approved by a majority vote of the members of the System and by a majority vote of the affected retirees of the System. Once the benefit changes are in effect, the Board of Administration has the plenary authority and fiduciary responsibility to administer the System. This includes responsibility, based on investigations, evaluations and determinations, to adopt such mortality, service and other tables and interest rates, and to make such revisions in rates of contributions of members as it deems necessary to provide the benefits that have been granted.

3. Employer Contribution Rates. The City Manager has proposed an Employer Contribution Rate Stabilization Plan. In that Plan, employer rates have been calculated using the projected unit credit (PUC) actuarial method. For FY96 and FY97, the City agrees to pay the budgeted (City-paid) rates of 7.08% and 7.33% respectively, and thereafter to increase the City-paid rate by 0.50% each year until the rate paid reaches the calculated rate using the entry age normal

actuarial method. At such time as the PUC and entry age normal rates are equal, the System expects to convert to the entry age normal actuarial method.

By the City Manager's proposal, the City will pay the rates shown in the Employer Contribution Rate Stabilization Plan chart for FY96 through FY2007. In the event that the funded ratio of the System falls to a level ten percent below the funded ratio calculated in the June 30, 1996, actuarial valuation, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated by an amount, determined by the actuary, that is necessary to restore the funded ratio to the proper level.

Nothing in this proposal changes the Board's discretion to adjust the actuarial assumptions on which the System is based as needed in order to insure the long-term funding integrity of the System. If the Board, upon recommendation of the System's actuary, adjusts the actuarial assumptions on which the System is based prior to July 1, 2007, which changes the employer contribution rate, the change in contribution rate will be passed on to the City by extending the incremental increases shown in the Employer Contribution Rate Stabilization Plan chart. If the phase in would require an extension past July 1, 2009, in order to achieve the full actuarial PUC rate, the City-paid rate will be adjusted by the amount necessary to reach by July 1, 2009, the rate calculated by use of the entry age normal method.

Provided that the City-paid rate in the Employer Contribution Rate Stabilization Plan is not less than an amount substantially equal to that required of employees for normal retirement allowances as certified by the actuary, the Board will be acting within the discretion granted to the Board to administer the System and discharging its fiduciary duties set forth in Article XVI, Sec. 17 of the California Constitution.

4. Surplus Undistributed Earnings and Reserves. The actuary has estimated that the past service liability created by the City Manager's proposal to increase benefits is $76.7 million expressed in 1996 dollars. Past service liability is the increase in the cost to the System to pay the benefits. No contributions have been received in the past to fund the increased benefits, and thus the result is an increased liability. The City Manager's Employer Contribution Rate Stabilization Plan provides for the employer contribution rate to be incrementally increased to the actuarially recommended rate over the next ten years. As a result, the System will be receiving less in

contribution dollars over that period, which creates an additional liability. The actuary estimates that the amount of contribution shortfall liability created by the Employer Contribution Rate Stabilization Plan is $30 million expressed in 1996 dollars.

The total of estimated increased liabilities associated with the City Manager's proposals is $106,700,000. You have informed me that the System has "surplus" undistributed earnings and a balance in the Earnings Stabilization Reserve as follows:

| | |
|---|---|
| FY ended 6/30/95 | $38,813,314 |
| FY ended 6/30/96 | $85,472,254 |
| Earnings Stabilization Reserve | $10.769620 |
| Total | $ 135,056,188 |

It is now proposed that the Board of Administration, credit the employer contribution reserve in the amount of $106,700,000 for the purpose of discharging the estimated liability for past service liability for increased benefits and employer contribution shortfall and credit the employer contribution reserve with the remaining balance of $28,356,188 for the purpose of reducing the System's normal unfunded liability. We believe that it is appropriate and the Board will be discharging its fiduciary responsibility to credit the employer contribution reserve as proposed, provided that the requirements of Section 24.0907.1(a) of the San Diego Municipal Code have been met. Under the controlling San Diego Ordinances, any actuarially determined surplus earnings can be credited to the employer contribution reserve. (See San Diego Municipal Code, Section 24.0907.1(b).)

This letter is provided solely to the San Diego City Employees' Retirement System and neither Frandzel & Share nor Hamilton and Faatz are assuming any professional responsibility to any other person whatsoever. This letter is furnished only in connection with the City Manager's proposal as outlined and summarized in this letter and may not be applied to subsequent changes in the proposal.

Yours very truly,

HAMILTON AND FAATZ
A Professional Corporation

By: Dwight Alan Hamilton
DWIGHT ALAN HAMILTON

FRANDZEL & SHARE
A Law Corporatiion

By: John A. Graham
JOHN A. GRAHAM

LA1.0055127.02

# EXHIBIT 5

City of San Diego
MEMORANDUM

Date: October 10, 1996

To: Honorable Mayor and City Council

From: Jack McGrory, City Manager

Subject: Legal Opinion from CERS Fiduciary Counsel

---

Attached for your information is a letter from Dwight Hamilton, Fiduciary Counsel to the CERS Retirement Board of Administration. Mr. Hamilton's letter provides his opionions regarding several legal issues referrred to him by CERS Board members at the time they were considering the Manager's Proposal regarding the retirement system.

JACK McGRORY
City Manager

cl

10/14/96
to Mayor + Council
only, not full
distribution

bcc: Ed Ryan
Pat Frazier

Original

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CAR01591

PENSION_R0000137

FRANDZEL & SHARE
A LAW CORPORATION
6500 WILSHIRE BOULEVARD
SEVENTEENTH FLOOR
LOS ANGELES, CALIFORNIA 90048-4920
TELEPHONE (213) 852-1000
FAX (213) 651-2577

BERT D. FRANDZEL
ARD HUDSON SHARE
DOLPH L. HOWARD
OMAS M. ROBINS, III
N A. GRAHAM
ONALD L. GRUZEN
ROBERT B. KAPLAN
DALE REID
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CRAIG A. WELIN
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HENRY G. WEINSTEIN
DAVID W. WISEBLOOD
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SHARI D. MARKS
SHIRLEY D. RAMIREZ
BRUCE D. POLTROCK
HOLLY R. RANDALL
SUZANNE KAHN WINNE
LISA ANN MILLER
JUDY MANLING LAM
ROBERT GONZALEZ
JULIE A. MARQUIS
JOON W. SONG
AMY FRANKEL

SAN FRANCISCO OFFICE
100 PINE STREET 26TH FLOOR
SAN FRANCISCO, CALIFORNIA 94111-5212
TELEPHONE (415) 788-7400
FAX (415) 291-9153

OF COUNSEL
HAMILTON AND FAATZ
DENVER, COLORADO
NOT ADMITTED IN CALIFORNIA

September 19, 1996

OUR FILE # 93596-001

Mr. Lawrence B. Grissom
Retirement Administrator
San Diego City Employees' Retirement System
Union Bank Building
525 "B" Street, Suite 1120
San Diego, CA 92101-4494

Dear Larry:

In the two public meetings with the CERS Board (Board) that I attended in which the City Manager's proposals regarding Contribution Rates, Benefits and Distribution of Earnings were discussed, we often referred to the "*Claypool*" case (*Claypool v. Wilson*, 4 Cal.App.4th 646, 6 Cal.Rptr.2d 77 (1992) *cert.* denied *sub nom* 506 U.S. 1034, 113 S.Ct. 812, 121 L.Ed.2d 865 (1992)). Ms. Parode, during discussions of the City Manager's proposals at the June 21, 1996 meeting, asked for an explanation of the *Claypool* case, the conclusions of law contained therein, and how those conclusions apply to the City Manager's proposal.

In *Claypool*, members of the Public Employees Retirement System (PERS) challenged *inter alia* a statute repealing supplemental cost of living (COLA) programs and directing that the funds be used to offset contributions otherwise due from PERS employers. The PERS members contended that the repeal of the supplemental COLA programs and the reallocation of the funds to offset employer contributions were unconstitutional because they impaired vested contract rights to funding, citing *Valdes v. Cory*, 139 Cal.App.3d 773, 189 Cal.Rptr. 212 (1983). Because the COLA funds were not previously counted toward the actuarial soundness of PERS, were not reserved to underwrite the actuarial soundness of the basic pension benefits, and were not tied to the provision of any special benefits required to be paid, the court found that COLA funds were available to offset the employer contributions that would otherwise be required to that end. The court made it clear that only surplus funds not previously identified as actuarial assets could be utilized as an offset to contributions.

This rule from *Claypool* is applicable to Issue No. 4 of the City Manager's proposal. This proposes that the Board credit the employer contribution reserve in the amount of $106,700,000 for the purpose of discharging the estimated liability for past service liability created by the City Manager's proposal to increase benefits (estimated to be $76.7 million in 1996 dollars) and the

CAR 01533-39
VEREP 01980-87

**VE SUM 08137**

SDCERS Non Priv A01 01541-47

PENSION_R0000138

estimated contribution shortfall liability created by the City Manager's Employer Contribution Rate Stabilization Plan (estimated to be $30 million in 1996 dollars). This credit would be provided by using "surplus" undistributed earnings together with the remaining balance in the Earnings Stabilization Reserve. Under the controlling provisions of the San Diego Municipal Code, Section 24.0907.1(b), surplus earnings can be credited to the Reserve for Employer Contribution, provided that the requirements of Section 24.0907.1(a) of the San Diego Municipal Code have been met.

According to the information that we have been provided, the System has "surplus" undistributed earnings as follows:

| | |
|---|---|
| FY ended 6/30/95 | $38,813,314 |
| FY ended 6/30/96 | $80,472,254 |

The remaining balance in the Earnings Stabilization Reserve is $10,769,620. None of these funds have been previously identified as actuarial assets by the Board. Therefore, under the criteria set forth in *Claypool*, they can be utilized as reserve for the deferred contributions.

*Claypool* is of equal importance to the Board in determining whether it is properly discharging its fiduciary duties in accepting the Contribution Rate Stabilization Plan. A trustee's duty of loyalty requires him or her to protect the integrity of the fund so that its actuarial soundness will not be impaired. Under the rule of *Valdes v. Cory*, 139 Cal.App.3d 773, 189 Cal.Rptr. 212 (1983), the members of the System have a vested right to an actuarially sound system. In discharging that duty, the Board is naturally concerned about the Plan's effect on the System. The court in *Claypool* held that vested contractual pension rights may be modified prior to retirement provided that the modification is reasonable. Citing the case of *Betts v. Board of Administration*, 21 Cal.3d 859, 148 Cal.Rptr. 158 (1978), the court in *Claypool* went on to say that a modification of a vested pension right is reasonable only if it "[bears] some material relation to the theory of a pension system and its successful operation," and if the modifications (which result in disadvantage to employees), are accompanied by comparable new advantages to the members. The *Claypool* court then stated that "The saving of public employer money is not an illicit purpose if changes in the pension program are accompanied by comparable new advantages to the employee." *Claypool*, 4 Cal.App.4th. at 665, 6 Cal.Rptr.2d at 88.

It appears that the City has found it difficult to work with the wide fluctuations in the Employer's contribution rate under the Projected Unit Credit (PUC) actuarial method, which was instituted in 1992. The City Manager indicated that the City had not anticipated the level of volatility that the PUC method has created, because of changes in the demographics of the System, particularly in the increased average age of active members. He stated that the

Employer's contribution rates have been driven to an unanticipated level, and the fluctuation in these rates have caused severe budgeting problems for the City.

The City Manager's Contribution Rate Stabilization Plan is therefore a modification of the pension system designed to effect economies for the benefit of the City. This modification is accompanied by an increase in benefits and other advantages granted to the beneficiaries and members in Issue No. 2 of the City Manager's Plan. The case law permits a pension system to be flexible enough to permit adjustments in accord with changing conditions if at the same time the integrity of the system is maintained, and the change bears some relation to the functioning and integrity of the system. *Wallace v. City of Fresno*, 42 Cal.2d 180, 265 P.2d 884 (1954). With the sunset provisions now being included in the City Manager's Contribution Rate Stabilization Plan, Issue No. 3, the actuary believes that the System is protected from permanent weakening. The stabilization of employer contribution rates is directly related to the functioning and integrity of the system. Thus, the modification appears to comply with the modification of vested rights rules of *Betts* and *Claypool*, and is consistent with the duty to minimize employer contributions set forth in Article XVI, §17(b) of the California Constitution.

Ms. Parode also asked questions at the public hearing concerning the Board's duty to determine the financial stability and viability of the City when the Board is asked to approve an action by the City that would increase the unfunded liability of the City. Following up on those questions, your letter of July 29, 1996, asked us whether the Board has a duty to determine the financial viability of the City before it approves contribution payments at a level less than that recommended by the actuary. In our opinion, the Board does have that responsibility.

Ms. Parode, in her comments at the June 21, 1996, public hearing on the City Manager's proposal, compared the approval of employer contribution payments at a level less than that recommended by the actuary to that of a retirement system loaning money to an employer. Before a bank makes a loan, it has the duty to determine the ability of the borrower to repay it. We believe that the Board is held to the standard of professional bankers and bank investment advisors. If a pension ~~fund~~ is asked to approve employer contribution payments at a level less than the amounts recommended by the actuary, because of the unfunded liability created, the fiduciary must determine the ability of the employer to provide the funds to deliver benefits and related services to the participants and their beneficiaries when they become payable.

To discharge the duty of determining the ability of the City to provide the funds to deliver benefits and related services to participants and their beneficiaries, the Board should give appropriate consideration to audited financial statements of the City; determine whether the City is reasonably carrying out and performing the municipal services required of it by the City Charter; determine whether it establishes a budget each fiscal year that anticipates the expenditures for those mandated services and the revenue necessary to fund them from a reasonable level of taxation, state aid, and other funds; and determine whether the City is paying its debts as they become due and is doing so without stress. In making its analysis the Board may need the advice and counsel of an expert who has extensive experience in municipal finance and government. Failure to carry out such an evaluation would be a breach of the duty of the Board to administer the system in a manner that will insure prompt delivery of benefits and related services to the participants and their beneficiaries as required by Article XVI, § 17(a) of the California Constitution.

We have found that a process for discharging the duty to determine the financial stability of the City is in place. Section 39 of the San Diego City Charter provides for the election of the City Auditor and Comptroller and sets forth his duties and responsibilities. Under Section 144 of the City Charter, the City Auditor and Comptroller is designated as a member of the Board of Administration. We understand that the City Auditor's office has a specific audit division, which conducts an operational and financial audit of the City. The City also employs an independent public accountant who conducts an annual independent audit of the City's finances, reviews all of the City's financial records and financial resources, and prepares a report on the financial stability of the City for the Retirement Board. The City's independent public accountant also certifies the surplus undistributed earnings for the system in accordance with Section 24.0907.1 of the San Diego Municipal Code.

Prior to entering into an agreement to approve employer contributions at a level less than that recommended by the actuary, the Board should carefully analyze the most recent financial statements of the City, the report of the independent public accountant, and ascertain his opinion as to the ability of the City to provide the funds to deliver benefits and related services to the participants and their beneficiaries considering the under-funding liability that is expected. The Board may also wish to have an independent expert in municipal finance and government give a second opinion to provide additional comfort to the Board in that decision.

Board member John Casey requested an opinion concerning the scope of the Board's authority and responsibility. He is correct in his submission that the Board's authority and responsibility is to administer the system. The Board has no authority to determine benefits or to make benefit changes. Benefit changes require the enactment of an ordinance amending the San Diego Municipal Code by the City Council and approval of the changes by a majority vote of the members of the system and by a majority vote of the affected retirees of the System. Once the benefit changes are in effect, the Board has the absolute responsibility to administer the system. As indicated above, a vested contractual pension right may be modified only if the modification bears some material relation to the theory of the pension system and its successful operation, and the modification is accompanied by comparable new advantages or benefits to the members. If the Board is asked to approve the modification of the vested right, it should under those circumstances determine that these are benefits to the participants and their beneficiaries that are comparable to the disadvantages to the participants and beneficiaries. Mr. Casey, however, is correct: the Board should not engage in negotiations for benefit changes or increases.

In his memorandum, Mr. Casey also raised a conflict of interest question. He stated:

> All the ex officio and elected Board members would gain some financial benefit in approving this action. This apparent conflict, in my opinion, is a real conflict. For the record, I do not believe that any member voted for this proposal for personal gain, rather it was inadvertent and due to the way the proposal was presented. Nevertheless, the conflict is real.

Following up on that memorandum, you have submitted to us a request for an opinion on the issue of whether the manner in which the City Manager's proposal was submitted created a conflict for Board members who would directly benefit personally from the proposed increase in retirement benefits.

As stated immediately above, changes or increases in benefits may be effected only by the enactment of an ordinance amending the San Diego Municipal Code adopted by the City Council, not by the Board. The benefit increases, if enacted by the City Council by ordinance, must be approved by a majority vote of the members of the System and by a majority vote of the affected retirees of the System. Once the benefit changes are in effect, the Board of Administration has the plenary authority and fiduciary responsibility to administer the System. This includes the responsibility, based on investigations, evaluations and determinations, to adopt such mortality, service and other tables and interest rates, and to make such revisions in rates of contributions of members as it deems necessary to provide the benefits that have been granted. The Board does not directly participate in the decision to increase benefits.

The modification and increase of benefits, as set forth in Issue No. 2 of the City Manager's proposal, however, is contingent upon the Board's approval of Issues No. 3 and 4. The question presented, therefore, is whether a retirement board member, who would benefit from a benefit increase outlined in Issue No. 2, would have a conflict of interest preventing him from voting on Issues No. 3 and 4. Viewing the City Charter as the document creating the trust, Section 144 creates a Board of Administration to manage the system. It consists of several persons expressly defined by the City Charter, including the City Manager, City Auditor and Comptroller, City Treasurer, three members of the Retirement System to be elected by the active membership, and one retired member of the Retirement System to be elected by the retired membership. These individuals are, of course, also members, participants or beneficiaries of the System, and the Charter drafters were aware of the possible conflicts of interest inherent in the appointment of those members of the Board. Under California law, "where a trustee is named by a settlor who is aware of the possible conflicts of interest inherent in the appointment, removal on the ground of conflict of interest is ordinarily unwarranted without an actual breach of trust. The bare potential for a conflict of interest does not categorically bar a fiduciary from functioning as a trustee. See *Claypool*, 4 Cal.App.3d at 676-771; 6 Cal.Rptr.2d at 95-96; *Matter of Gilliand's Estate*, 73 Cal.App.3d 515, 528, 140 Cal.Rptr. 795, 802 (1977); Restatement (2d) of Trusts § 107 comment f (1959).

Article XVI, § 17(b) of the California Constitution states:

> (b) The * * * members of the retirement board of * * * a public pension or retirement system shall discharge * * * their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board's duty to its participants and their beneficiaries shall take precedence over any other duty.

If a trustee, in making decisions as a trustee, acts solely and exclusively in the interest of and for the purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system, the trustee does not violate his or her fiduciary duties to the system. If a Board member fulfills this duty in making decisions, he or she will not be violating his or her duties under Government Code section 87100[1], the Code of Ethics of the City of San Diego, California[2], or Council Policy 000-4.[3]

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[1] "No public official at any level of state or local government shall make, participate in making or in any way attempt to use his official position to influence a governmental decision in which he knows or has reason to know he has a financial interest."

[2] "First: No elected official, officer, appointee or employee of The City of San Diego shall engage in any business or transaction or shall have a financial or other personal interest, direct or indirect, which is incompatible with the proper discharge of his official duties or would tend to impair his independence or judgment or action in the performance of such duties."

[3] "No elected official, officer, appointee or employee of The City of San Diego shall engage in any business or transaction or shall have a financial or other personal interest, direct or indirect, which is incompatible with the proper discharge of his official duties or would tend to impair his independence or judgment or action in the performance of such duties."

For the foregoing reasons, it is our opinion that those Board members who voted in favor of the proposal solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system, did not have a conflict of interest sufficient to bar him or her from functioning as a trustee.

This letter is provided solely to the San Diego City Employees' Retirement System and neither Frandzel & Share nor Hamilton and Faatz are assuming any professional responsibility to any other person. This letter is furnished only in connection with the City Manager's proposal as outlined and summarized in this letter and in response to your letter of July 29, 1996, including the attachments.

Yours very truly,

HAMILTON AND FAATZ,
A Professional Corporation

By Dwight Alan Hamilton
DWIGHT ALAN HAMILTON

FRANDZEL & SHARE
A Law Corporation

By John A. Graham
JOHN A. GRAHAM

# EXHIBIT 6

A-7

# City of San Diego

Closed Session

March 14, 2000

1

## Status of Negotiations

- 2 sets of parallel negotiations underway
  - Successor/Extensions of MOU's
  - Corbett Litigation/Mediation

2

Corbett

Vs.

City of San Diego And

City Employees' Retirement System

(CERS)

3

## Negotiations for Corbett Case Settlement

- "Tag Along" case to *Ventura Deputy Sheriffs v. Ventura Co Board of Retirement*
- Ventura case held that retirement benefits under CERL must be calculated on virtually all compensation, including fringe benefits, rather than only "base" compensation
- City is currently in mediation with plaintiffs to attempt settlement

4

## Corbett case seeks to include Fringe Benefits in definition of compensation:

- Uniform Pay
- Terminal Leave / Value of annual vacation accrual
- Flex Plan Value
- Mileage Reimbursement
- Auto Allowance
- Retirement Contributions Offset
- Annual Leave Pay in Lieu

5

## Corbett Case Risk

- $743+ Million Expense
- $75 Million annual cost
- 31% increase in retirement benefit
- SDCERS Funded ratio reduced to 70% from 94.4%

6

## Terms of Mediated Corbett Settlement

- Retired Employees: 7% benefit increase
- DROP participants 7% retro and 10% benefit prospective increase
- Active Employees Choice of:

Enhanced formula
3% @ 50 for Safety Members
2.25% @ 55 for General Members

OR

10% increased benefit on existing formula

7

## Funding of Corbett Settlement

Fund Settlement through CERS

- Reduction in funded ratio
  - Current CERS funded ratio = 94.4%
- Cost of Formula Enhancement reduces funded ratio by (-3.05%) ($60 million)
- Cost of Choice reduces funded ratio by (-.9%) ($18 million)
- Reduces funded ratio to 90.4%

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SEC REQUEST 6/05

CA10022

CS00118

PENSION_A0000026

## Funding of Corbett Settlement

Fund Settlement through CERS

- Retiree portion from CERS Undistributed Earnings
- Active Portion comes from:
  - Reduction in CERS funded ratio to 90 4%
  - Increased Employee and Employer Contributions

9

## Cost of Corbett Settlement

(Approximate Cost)

- Total Cost not $743M, but $162M
- Annual Cost not $75M/year, but $10.7M/year
- Benefit Increase not 31%, but 10% benefit increase
  - Retired: 7%
  - Active 10%+ (depending on election)
- Plaintiff's Attorney's Fees

10

## Corbett Schedule

Assuming Settlement

- Mediation - March 1, March 13, and March 15, 2000
- Provide notice to settlement Classes - March 30, 2000
- Public Comment - March 31 - May 1, 2000
- Judicial Certification of Settlement - May 10, 2000
- Absent negotiated settlement, Corbett case scheduled for hearing May 26, 2000.

11

## Corbett Settlement Requirements

- Tentative Agreement of Parties (3/13/00)
- City Council Authorization of Settlement Deal Points (3/14/00)?
  - Contingent upon verification of actuarial costs
- CERS Board Authorization
- CERS Membership Vote of Approval
- Salary Ordinance Amendment redefining "compensation" to address Corbett issue.

12

## Negotiations for Successor/ Extension of Memoranda of Understanding

| MOU | Expiration Date |
|---|---|
| ▪ P.O.A. | June 30, 2000* |
| ▪ Firefighters, Local 145 | June 30, 2001** |
| ▪ M.E.A. | June 30, 2001** |
| ▪ AFSCME, Local 127 | June 30, 2001** |

* Informal Negotiations currently underway
**Re-opener provisions are triggered if a proposal for "economic improvement" is made to the P.O.A.

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## MOU Negotiations Schedule with Corbett Settlement

- Week of March 20, 2000 - Closed Session Council Direction re: Negotiations Package
- Prior to April 1, 2000 - Written offer to POA for 2 year contract extension
- Concurrently, POA offer triggers reopener provision with Local 145, MEA and AFSCME Local 127.
- May 15, 2000 - Impasse Hearing if necessary (POA only)
- May 16, 2000 - Council adoption of Salary Ordinance
- July 1, 2000 - Commence successor MOUs

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## Recommendations

- Direct City Manager to finalize Settlement Agreement
- Finalize "Informal" Negotiations with P.O.A.
- Seek Council authority week of March 20, 2000, to:
  - Extend written offer to POA for 2 year extension of MOU (through 6/30/02)
  - Commence negotiations with Local 145, MEA and AFSCME Local 127 for 1 year extensions of MOUs (through 6/30/02)
- Schedule Additional Special Closed Sessions with Council to provide updates prior to May 15, 2000 on status of:
  - Negotiations
  - Impasse potential
- Amend Municipal Code to codify Settlement

15

16

CA10024

SEC REQUEST 6/05

CS00120

PENSION_A0000028

## Formula Enhancement Impact on Retirement Benefit

| Safety Member | | General Member | |
|---|---|---|---|
| Current | $25,000 | Current | $16,000 |
| *With 3% @ 50* | ***$30,000*** | *With 2.25% @ 50* | ***$18,000*** |

17

## SDCERS Funding Impact

| Scenario | Annual Cost | Impact on Current Funding Ratio | Funded Ratio |
|---|---|---|---|
| Now | No Change | 0 | 93.2% |
| Formula Enhancement | $5.8M | (-3.05%) | 90.15% |
| Possible Settlement | $14 4M | (-9.50%) | 83.7% |
| All Corbett Claims | $75.0M | (-24.8%) | 68.40 |

Total Exposure from Corbett = $743 million

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## Corbett Impact on Retirement Benefit

| Safety Member | | General Member | |
|---|---|---|---|
| ▪ Current | $25,000 | Current | $16,000 |
| ▪ Possible Settlement | $27,500 | Possible Settlement | $17,600 |
| ▪ All Claims | ***$32,753*** | *All Claims* | ***$21,019*** |

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## SDCERS

Retirement Benefit Calculation is a function of Three Factors:

- Years of Service
- Multiplied by a % Factor
- Multiplied by employee's highest one year compensation

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SEC REQUEST 6/05

CA10025

CS00121

PENSION_A0000029

## Current Retirement Formula Example

| Safety Member (Age 50) | General Member (Age 55) |
|---|---|
| 20 years of service | 20 years of service |
| 2.5% Factor | 2.0% Factor |
| Applied to salary ( e.g. $50,000) | Applied to salary ( e.g. $40,000) |
| (20 years x 2.5% x $50,000) = $25,000 annual benefit | (20 years x 2% x $40,000) = $16,000 annual benefit |

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#7

# Corbett Settlement Term Sheet

1

## Retired and Vested Deferred Members

- Retroactive benefit increase 7% (to 7/1/95) to be paid in lump sum
- Prospective benefit increase 7%
  - Contingent upon sufficient undistributed earnings
  - Payment hierarchy: between Health Ins. Premium and 13th Check
  - Any unpaid amounts accumulated and paid in future years contingent upon sufficient undistributed earnings

2

## DROP Members

- Prospective benefit increase: 10%
- Retroactive benefit increase: 7%

3

## Active Members

- Election at time of retirement
- Formula increase or Retirement benefit increase.
  - Safety: from 2.5% to 3% @ 50
  - General: 2% to 2.25% @ 55

  OR

  - 10% increase in final compensation without formula increase
- Employee contribution for election costs (est. .15%) paid from SDCERS Employee Benefit Reserve

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SEC REQUEST 6/05

CA10027

CS00123

PENSION_A0000031

## Conditions

- Actuary Confirmation that settlement will not lower funded ratio below 90%
- Plaintiff's Attorney's Fees

# EXHIBIT 7

CITY OF SAN DIEGO
# MEMORANDUM

DATE: April 13, 2000

TO: Honorable Mayor and Councilmembers

FROM: Bruce A. Herring, Deputy City Manager

SUBJECT: Corbett Settlement

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As part of the conditions of the Corbett Settlement (Corbett et al.V City Employee Retirement System), the SDCERS was to retain a funded ratio in excess of 90.0% after the conditions of the settlement had been met. This was to be confirmed by the SDCERS Actuary, Gabriel, Roeder, Smith & Company.

Larry Grissom, the SDCERS Administrator, has received the written confirmation from Rick Roeder of Gabriel, Roeder, Smith & Company attesting to the fact that the condition of the settlement has been reached. A copy of the Mr. Roeder's letter is attached for your information.

Please contact me if I can provide any additional information.

Bruce A. Herring
Deputy City Manager

Attachment

cc: Michael T. Uberuaga, City Manager
Larry Grissom, Retirement Administrator
Ed Ryan, City Auditor and Controller
Casey Gwinn, City Attorney
David Hopkins, Hillyer & Irwin

VE REP 02870

PENSION_A0000057

Cc: Larry ✓
Vincent
Orig.: Sally

GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries
9171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 858-535-1300 • FAX 858-535-1415

March 30, 2000

Mr. Larry Grissom
City of San Diego Employees' Retirement Association
401 B Street, 4th Floor
San Diego, CA 92101

Dear Larry,

You had asked us for an updated "funded status" for your System if certain liability increases related to the Corbett litigation occur. For purposes of our summary, the funded ratio shall be inclusive of the Unified Port District.

As of the June 30, 1999 valuation, the aggregated funded ratio was 94.4% (On a stand-alone basis, the City's funded ratio was 93.2%)

As part of the Corbett litigation, Drew James of William M. Mercer, Inc. was asked to develop analysis in regard to potential liability increases. Our understanding is that Mercer's estimate of increased liabilities was 102 million dollars for active members. If this impact were to have been reflected in the 1999 valuation, the aggregate funded ratio would have decreased to 90.3%. Thus, we estimate the resulting decline in the funded ratio to be 4.1%.

It is our understanding that there are contingent additional liabilities associated with retired and vested deferred members. Our understanding is that such contingent liability is currently estimated to be 84 million dollars. While our understanding is that such contingency will preclude inclusion in System liabilities until after the June 30, 2000 valuation date "snapshot", we do wish to state the funded ratio would have declined further to 87.2% if a further 84 million dollar increase in liabilities in the 1999 valuation had been reflected.

**All parties should be aware that these funded ratios developed in the June 30, 2000 valuation will deviate from those above due to actual experience being different from that assumed. Also, the funded ratio will be impacted to the extent that the contribution rate per the Manager's Proposal is less than the actuarially computed rate.**

Sincerely,

Rick Roeder
Rick A. Roeder, EA, FSA, MAAA

VE REP 02869

PENSION_A0000058